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Zhodnocení aktivity společnosti GOME Electrical Appliances Holding Limited

Evaluation of Activity of the Company GOME Electrical Appliances Holding Limited

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The declaration

"Herewith I declare that I elaborated the entire thesis, including all annexes, independently."

Ostrava dated...../../5../2014.....

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Contents

1. Introduction

GOME Electrical Appliances Holding Limited Company is one of the biggest home appliances company in China, do you know the basic financial situation of this company? Do you know what should the managers do to help GOME running well? These problems will be solved in this thesis by using some financial analysis methods.

The goal of the thesis is to analyze the financial situation in GOME, the activity evaluation will be laid emphasis on and we will give suggestions to solve the problem in GOME by using methods of financial analysis.

In chapter 2, we will introduce the basic financial analysis methodology. The key points of this chapter will be the structure of financial statements, common-size analysis, financial ratios and pyramidal decomposition analysis. We will introduce balance sheet, income statement and cash flow statement in the part of financial statements. For financial ratios, we will introduce five kind of important indicators: profitability ratios, liquidity ratios, solvency ratios, market data and activity ratios, and we will focus on activity ratios. Pyramidal decomposition analysis is an important method for financial analysis, and this important method will be introduced in the end of chapter 2.

We will introduce some basic information about GOME in chapter 3. We can know the background, history and main competitor of GOME from this chapter. Besides, we will also see the simplified financial statements from 2007 to 2012 in this chapter; this can help us figure out the financial situation of GOME comprehensively. At the end of this chapter will be the common-size analysis of GOME.

Chapter 4 is the most important application part of this thesis. In chapter 4, we will calculate the important financial ratios of GOME and lay emphasis on the activity ratios. Then we will use pyramidal decomposition analysis to decompose activity ratios and find the main problem in operating process. At last we will try to figure out how to solve these problems and give some suggestions to help GOME operate well.

In the last chapter, we will summarize all the results we discussed before and give a clear solution for the problem we found.

2. Description of Activity Evaluation Methodology

In this part of the thesis, we will first comprehend the description of financial analysis methodology. Then the financial statements which are the data sources for financial analysis will be introduced. At last we will introduce important methods include the common-size analysis, financial ratios analysis and pyramidal decomposition analysis. All the methods we have introduced in this chapter will be used in the following application part.

2.1 Financial analysis

In this chapter, most of the descriptions are based on the information from Booth, Cleary and Drake (2013, p311).

Financial analysis is using accounting information and other related data, by calculating financial indicators to analyze and estimate economic relationships as well as financial results in financial activities. Information for financial decision-making, financial assessment, supervision and regulation is been provided.

The sources of information for financial analysis come from three aspects: financial data from the balance sheet, the income statement and the cash flow statement; market data come from the securities prices, industry statistics and so on; economic data come from GDP[1], PPI[2] and so on.

The methods of financial analysis can be divided into three groups: common-size analysis which includes horizontal analysis and vertical analysis, financial ratio analysis and pyramidal decomposition analysis. The evaluation of financial analysis results can be shown from following aspects: results evolution over the time; results comparison with competition or industry statistics; comparison of true results with the plan; comparison with recommended values, for example rating agencies.

[1] Gross Domestic Product

[2] Producer Price Index

2.2 Financial Statements

To analysis the whole financial situation of a company, some basic data of company should be known, and the most useful data are been shown in the form of financial statements. The financial statements include three parts: the balance sheet, the income statement and the cash flow statement.

The most of descriptions in this chapter are based on the information stated by Ittelson (2009).

2.2.1 Balance Sheet

The balance sheet presents the financial picture of the company. We can find much useful information about the company in the balance sheet. Some data in the balance sheet will be used to calculate financial ratios of the company. And balance sheet includes three parts: assets show what the enterprise has today; liabilities show how much the enterprise owes today; owner's equity shows what the enterprise is worth today.

There exist a basic relationship in the balance sheet, it shows what we has today is equal to the sum of what we owes today and how much we worth today, and this relationship can be also described in the formula 2.1.

$$TA = TL + E. \tag{2.1}$$

Where TA is "total assets", TL is "total liabilities" and E is "owner's equity".

Assets are everything a company has owned like cash in the bank and machines. It can also represent certain rights that have monetary value. Assets can be separated into current assets and non-current assets. Current assets are the assets that can be converted into cash in less than 12 months, this kind of assets have high liquidity and low profitability. In addition to current assets, there exist non-current assets, which are the sum of other assets and net fixed assets. Ittelson (2009, p28) states the definition of other assets and net fixed assets with the following:

"*Other assets is a catchall category that includes intangible assets such as the value of patents, trade name and so forth. The net fixed assets of a company are the*

sum of its fixed assets' purchase prices ('fixed assets @ cost') minus the depreciation charges take on the Income Statement over the years ('accumulated depreciation').''

Table 2.1 Simplified Structure of Balance Sheet

The Balance Sheet			
Assets		Liabilities & Equity	
Cash	A	Accounts Payable	K
Accounts Receivable	B	Accrued Expenses	L
Inventory	C	Current Portion of Debt	M
Prepaid Expenses	D	Income Taxes Payable	N
Current Assets	**A+B+C+D=E**	**Current Liabilities**	**K+L+M+N=O**
Other Assets	F	Long-term Debt	P
Fixed Assets At Cost	G	Capital Stock	Q
Accumulated depreciation	H	Retained Earnings	R
Net Fixed Assets	**G-H=I**	**Shareholder's Equity**	**Q+R=S**
Total Assets	**E+F+I=J**	**Total Liabilities & Equity**	**O+P+S=T**

Source from Ittelson (2009, p17).

Liabilities are the economic obligations of company. We can see from table 2.1, liabilities include two parts: current liabilities and long-term debt. Current liabilities must be paid within 12 months; cash generated from current assets are used to cover current liabilities. Long-term debt refers to the loan with maturity of more than one year.

Shareholder's equity represents the value of company that belongs to its owners. Capital stock is the original amount of money that owners invested in the form of stock. Retained earnings are earnings of company that have not been paid to the shareholders as dividends. Capital stock and retained earnings make up of the shareholder's equity.

2.2.2 Income Statement

One of the most important parts of company's financial statements is income statement, the important information to calculate the profitability of company is been given in the income statement, and profitability is an important perspective on the health of a company.

Table 2.2 Simplified Structure of Income Statement

Income Statement	
Net Sales	1
Cost of Goods Sold	2
Gross Margin	**1-2=3**
Sales & Marketing	4
Research & Development	5
General & Administrative	6
Operating Expenses	**4+5+6=7**
Income From Operations	**3-7=8**
Interest Income	9
Income Taxes	10
Net Income	**8+9-10=11**

Sourced from Ittelson (2009, p44).

The income statement shows the business performance of a company over a period of time. So the basic relationship in the income statement can be described in a simple equation shown in the formula 2.2.

$$Sales - Costs\ \&\ Expenses = Income. \tag{2.2}$$

We will explain some important items in the income statement. The first item is net sale. Net sales mean the amount of money that company will finally collect from a deal.

It is been record in the income statement when the company actually have delivered products to customers, this means the customers have the obligation to pay for the products. Cost of goods sold is the costs to produce the products until the products are sold. When the company made the product, it takes costs and this amount of value will add to the value of inventory in the balance sheet, only when the sale is dealt and the inventory is sold does its value move from balance sheet to the income statement as cost of goods sold. Gross Margin is rest of the amount of money from sales after cost of goods sold is deducted.

There are two different terms in the income statement, cost and expense, they are both the indicators to describe how company spends its money, but cost only refers to manufacturing expenditures to produce goods as inventories and expenses are all the other expenditures.

There are net sales in the top line of the income statement and the net income in the bottom line, they are totally different items. Net sales refer to the revenue of the company and net income refers to the profit of the company.

2.2.3 Cash Flow Statement

Ittelson (2009, p62) states that *"the cash flow statement reports the movement of cash through business over a period of time."* The cash flow statement records all the cash flow happened during transaction processes.

In the cash flow statement, we have two description of the direction that money flows. If the company received cash in the period, we call this kind of movement "inflows"; if the company spent cash in the period, we call this kind of movement "outflows". The basic relationship in the cash flow statement is based on the cash movement and the relationship can be described in the formula 2.3.

$$Beginning + Inflow - Outflow = Ending. \quad (2.3)$$

Cash inflows have two main ways: one is from operating activities, like receiving payment for goods; another is from financing activities, like taking a loan or issuing stocks. Cash outflows have four major ways: operating activities like paying factory

rent; financial activities like paying dividends; paying taxes to the government; making investments in fixed assets like software and machines.

Table 2.3 Simplified Structure of Cash Flow Statement

Cash Flow Statement	
Beginning Cash Balance	**a**
Cash Receipts	b
Cash Disbursements	c
Cash From Operations	**b-c=d**
Fixed Asset Purchase	e
Net Borrowing	f
Income Taxes Paid	g
Sale of Stock	h
Ending Cash Balance	**a+d-e+f-g+h=i**

Source from Ittelson (2009, p62).

Operations are the normal day to day business activities, and cash from operations are the cash flow generated from these basic business activities like making inventories and selling goods. For example, cash receipts is the activity that company receives money from customers and cash disbursements is the activity that company pays for its materials, rent or goods from manufacturers. The difference between cash receipts and cash disbursements is cash from operations. Fixed assets purchase is the money that company spends to buy fixed assets like property, plant and equipment. Net borrowing is cash inflow activities; this activity will increase the amount of cash on hand. Income taxes paid is the taxes that company will pay to the government; it will decrease the amount of cash on hand. Sale of stock is the activity that company sells its stock to investors; it will increase the amount of cash on hand.

2.3 Common-size Analysis

Most of the descriptions in this chapter are based on the information from Booth, Cleary and Drake (2013).

Common-size analysis is the fundamental method of financial analysis. Common-size analysis can briefly show the relationship between the same items of different periods or the relationships between different items in the same period. Common-size analysis includes two types of analysis: vertical common-size analysis and horizontal common-size analysis.

2.3.1 Vertical Common-size Analysis

Vertical common-size analysis is used to measure the proportion of each item to benchmark during a specific period. We compare the results from different periods to find out the changes in the proportion of each item.

The most important item in vertical common-size analysis is the benchmark. For the assets part of balance sheet, we can choose total assets as benchmark, and each item will be written as a percentage of total assets. For the rest part of balance sheet, we can choose the sum of equity and liabilities as benchmark. If we want to study the case deeper, we can choose a specific item as benchmark and study the proportion of its inclusive items. For example, we can choose current assets as benchmark and study the proportion of cash, inventory, account receivables and prepaid expenses. For income statement, we usually choose total revenue as benchmark.

We can use formula 2.4 for calculating the relationship in vertical common-size analysis:

$$proportion = \frac{X_i}{\sum X_j}. \tag{2.4}$$

Where X_i is the amount of item that we want to study, X_j is the amount of benchmark.

2.3.2 Horizontal Common-size Analysis

Horizontal common-size analysis is used to compare each item in financial statements with the results of benchmark; the benchmark of horizontal common-size analysis is a specific period. We can choose a fixed period as benchmark, like we choose the results in 2008 as benchmark; and we will use every year's results to compare with results in 2008. Or we can choose every year's previous year as benchmark, for example, the benchmark of 2008 is 2007, the benchmark of 2009 is 2008.

We can get the information of changes for each item during the time evolution, whether the item is increase or decrease can be easily found in horizontal common-size analysis. We can use formula 2.5 to calculate the absolute change between time periods:

$$\Delta X = X_n - X. \tag{2.5}$$

Where ΔX is the change between the amount of studied year and benchmark year, X_n is the amount of studied year and X is the amount of benchmark year.

If we want to see the percentage of how much the items change, we can use formula 2.6 to calculate the relative change:

$$\Delta X\% = \frac{\Delta X}{X}. \tag{2.6}$$

Where $\Delta X\%$ is the percentage change between the amount of studied year and benchmark year.

2.4 Financial Ratio Analysis

Most of the descriptions in this chapter are based on the information been stated by Booth, Cleary and Drake (2013).

Financial ratio analysis is using data in the form of ratio to analyze and measure financial health of a company. Ratio is easily to read and it can explain lots of things,

different ratios have different meanings, we can briefly classify financial ratios into five categories:

- Profitability ratios, can assess the ability of generating profit from the investment.
- Liquidity ratios, can assess the ability of covering company's short-term obligation.
- Solvency ratios, can measure the level of financial risk of a company.
- Activity ratios, can assess the ability of whether a company can use assets well.
- Market data, can provide information for investors.

2.4.1 Profitability Ratios

Return on Equity The return on equity (*ROE*) ratio can be calculated as:

$$ROE = \frac{EAT}{E}. \tag{2.7}$$

Where EAT is "earnings after tax", or we call it "net income", and E refers to "shareholder's equity". The net income is the amount before dividends paid to common stockholders but after dividends paid to preferred stockholders. And shareholder's equity does not including preferred shares. This indicator measures the efficiency on generating profits from every unit of shareholder's equity.

Return on Assets The return on assets (*ROA*) ratio shows the ability of generating profit from assets. This indicator can be calculated as:

$$ROA = \frac{EAT}{TA}. \tag{2.8}$$

Where *TA* is "total assets", this indicator is a useful ratio for comparing competitors in the same industry, and it will change widely between different industries. Company that requires large initial investments will generally have lower *ROA*.

2.4.2 Liquidity Ratios

Current Ratio The current ratio measures whether company can meet short-term obligation or not. It is expressed as following:

$$CR = \frac{CA}{CL}. \tag{2.9}$$

Where *CR* is "current ratio", *CA* is "current assets" and *CL* refers to "current liabilities". This ratio varies from industry to industry, low values for the current ratio indicate that company will have difficulty in meeting short-term obligations, but if *CR* is too high, it shows the company cannot be efficiently using its current assets, this also shows the problems in working capital management.

Quick Ratio It also called acid-test or liquid ratio. This ratio measures the ability of company in using the most liquid assets to meet current liabilities immediately. The most liquid assets refer to assets that can be quickly converted to cash with low cost, which include cash and cash equivalent, short-term marketable securities and account receivables. It can be expressed as:

$$QR = \frac{Cash + MS + AR}{CL}. \tag{2.10}$$

Where *QR* means "quick ratio", *Cash* is "cash and cash equivalent", *MS* is "short –term marketable securities" and *AR* is "account receivables". Generally, the quick ratio should be 1 or higher, but it also varies widely from industry to industry, under normal circumstance, the higher the ratio, the greater the company's liquidity. Company with quick ratio of less than one cannot currently fully pay back its current liabilities.

2.4.3 Solvency Ratios

Debt-to-assets Ratio This ratio is used to assess a company's financial risk. It measures how much of the company's assets have been financed with debt. It can be calculated as:

$$D/A = \frac{TD}{TA}. \tag{2.11}$$

Where *D/A* is "debt to assets ratio", *TD* is "total debt" and *TA* refers to "total assets". The higher the ratio, the more leveraged the company, the greater the financial risk. It

varies from industries, with capital intensive businesses such as utilities and pipelines having much higher debt ratios than other industries like technology.

Debt-to-equity Ratio Booth, Cleary and Drake (2013, p330) states that *"With the debt-to-equity ratio, we compare the uses of debt and equity as sources of capital to finance the company's assets, evaluated using book values of the capital sources, which are provided on the balance sheet."* It can be calculated as:

$$D/E = \frac{TD}{E}. \tag{2.12}$$

Where *D/E* means "debt to equity ratio", *E* is "total equity". This ratio is a measurement of all of a company's future obligations on the balance sheet relative to equity.

Financial Leverage It is also named "the equity multiplier"; it is the degree to assess how much company uses its fixed obligation to acquire assets. It can be expressed as:

$$FL = \frac{TA}{E}. \tag{2.13}$$

Where *FL* is "financial leverage". Booth, Cleary and Drake (2013, p330) states that *"The greater the use of debt relative to equity in financing the company, the greater the financial leverage ratio will be."*

2.4.4 Market Data Ratios

EPS (Earnings per Share) It is the dollar value of earnings per share of company's common stock. Preferred stock rights have precedence over common stock, so the dividends declared on preferred shares are deducted before calculating the *EPS*, the *EPS* can be calculated as:

$$EPS = \frac{EAT}{NS}. \tag{2.14}$$

Where *NS* refers to "number of shares outstanding".

Price-to-earnings Ratio (P/E) It can be expressed as:

$$P/E = \frac{MPS}{EPS}. \tag{2.15}$$

Where *MPS* refers to “marketing price per share”.

2.5 Activity Ratios

Activity ratios can evaluate the benefits produced by assets. Managers use activity ratios as guides to assess how efficiently company manages assets such as inventory, receivables and fixed assets and so on.

This chapter is written based on the information stated by Lucey, Megginson and Smart (2008) and Booth, Cleary and Drake (2013).

2.5.1 Receivable Turnover Ratio

Receivable is an important part of current assets, if the account receivables can be recovered in time, the capital usage efficiency can be increased.

This ratio is the average times of receivables convert into cash in a fiscal year; it shows the speed of receivables turnover. We usually use the receivable turnover in days to express in how many days the account receivables were collected during the past fiscal year.

The formulas of receivable turnover ratio can be shown as following:

$$RT = \frac{TR}{AAR}. \tag{2.16}$$

Where *RT* is “receivable turnover ratio”, *TR* is “total revenue” and *AAR* is “average account receivables”. The numeric of *TR* is equal to the amount of sales comes from the income statement and *AAR* comes from the balance sheet.

And the receivable turnover in days can be calculated as:

$$RD = \frac{AAR \cdot 365}{TR}. \tag{2.17}$$

Where *RD* stands for “receivable turnover in days”; receivables shown as days outstanding is the average length of time when company’s account receivables are recovered. It is the length from the time that goods are on credit to the time that customers pay.

Generally speaking, over a period of time, the higher the receivable turnover ratio, the shorter the average collection period is. It also shows the recovery of receivables will be faster, and the less the bad debt loss is. Otherwise, the operating capital of company will be tied up in receivables, which will affect the normal capital turnover.

At the same time, *RD* should be as short as possible. If the *RD* is too long, it means the default time of debtor is long, the creditworthiness is low, and the risk of bad debt loss is high. Long *RD* also shows the ineffective of collecting receivables in time, which turned the capital into stagnant; this is very bad for the normal production and management of capital. But on the other hand, if the *RD* is too short, the terms of payment may be too harsh, and this will limit the enlargement of sales volume.

2.5.2 Inventory Turnover Ratio

Inventories make up a large proportion of current assets; we must attach importance to the analysis of inventories. Booth, Cleary and Drake (2013, p322) states that *"Inventory turnover is the ratio of cost of goods to inventory. This ratio is an indication of the resources tied up in inventory relative to the speed at which inventory is sold during the period."*

The formulas of inventory turnover ratio can be shown as following:

$$IT = \frac{CG}{AI}. \tag{2.18}$$

Where *IT* is "inventory turnover ratio", *CG* is "cost of goods sold", *AI* is "average inventory". The numeric of *CG* comes from the income statement and *AI* comes from the balance sheet.

Another expression of the speed of inventory turnover is "inventory turnover in days"; it can be shown as:

$$ID = \frac{AI \cdot 365}{CG}. \tag{2.19}$$

Where *ID* refers to "inventory turnover in days". Generally speaking, the higher the speed of inventory turnover, which means the higher the *IT* or the shorter the *ID*, will

lead to the lower occupied level of inventories and higher efficiency. This tells us the ability to meet short-term obligation is stronger. Improving the *IT* means the liquidity of company and the efficiency in the use of inventory will be improved, and vice versa.

Whether level of *IT* (or *ID*) is good or bad tells us the level of inventory management is high or low. In general, if the business of company run smoothly and the inventory turnover ratio is high, it means the speed of inventory turnover is faster and the state of operation is good, the amount of working capital occupied in inventories will be less.

We should keep a watchful eye on the structure of inventories, like proportional relation in finished goods, goods in process and raw materials. In general, there exist some specific relationships between inventory items, if the proportion of one item has significant change, there must have some problem in the management processes. For instance, if there is large increase in the amount of finished goods, it means the proportion of finished goods increase a lot; this is probably because the products don't sell well, the inventories can't be sold quickly and this will cost lots of storage fees. The corporations have to slow down the speed of production to keep the company running well.

2.5.3 Current Assets Turnover Ratio

Current assets turnover ratio is an important indicator to reflect the speed of current assets turnover, and it is also an important indicator to estimate the level of capital utilization.

The formula of current assets turnover ratio can be shown as following:

$$CAT = \frac{TR}{ACA}. \tag{2.20}$$

Where *CAT* is "current assets turnover ratio", *ACA* is "average current assets". The numeric "average current assets" comes from the balance sheet.

This ratio can also express as "current assets turnover in days" to assess in how many days the current assets were collected. It can be calculated as following:

$$CAD = \frac{ACA \cdot 365}{TR}. \tag{2.21}$$

Where *CAD* is "current assets turnover in days".

CAT is a significant indicator that shows analysis of utilization efficiency of assets from the perspective of current assets which has the highest liquidity. In general, over a certain period of time, the larger the *CAT* is, the better the efficiency of using current assets is. If we use *CAD* to describe current assets turnover ratio, the less days we need to complete turnover process means the time of current assets remain in every stage of producing and selling is shorter, and the speed of turnover is faster. If any stage of producing or selling has been improved in the corporations, it will directly shows on shorten of *CAD*. The *CAD* can directly reflect the improvement of company's production and operation, and is convenient to compare *CAD* in different period, so it is widely used in the analysis.

Through analyzing *CAT*, we can improve inner management, and use current assets efficiently and sufficiently, for instance, reduce costs or transfer the spare cash for short-term investment to get profit. Generally speaking, if the *CAT* is higher, the speed of current assets turnover will be faster, and under this circumstance, the current assets can be used efficiently, and it shows that the proportion of current assets in company is appropriate. But if the speed of turnover is slower, it maybe reflects the problem that the proportion of current assets is too large, too much capital are tied up in current assets, this is bad for the company.

2.5.4 Fixed Assets Turnover Ratio

Fixed assets turnover ratio is the ratio between total revenue and average fixed assets. This indicator reflects the efficiency of using the fixed assets like existing factory, constructions, and machineries to generate income.

The formula of fixed assets turnover ratio can be shown as following:

$$FAT = \frac{TR}{NVFA}. \tag{2.22}$$

Where *FAT* is "fixed assets turnover ratio", *NVFA* is "net value of fixed assets". *NVFA* is equal to original value of fixed assets minus accumulated depreciation.

Similar with other activity ratios, we sometimes use fixed assets turnover in days to describe in how many days can the fixed assets covert into cash. It can be expressed as following:

$$FAD = \frac{AFA \cdot 365}{TR}. \tag{2.23}$$

Where *FAD* is "fixed assets turnover in days".

In general, the higher *FAT* the better and the shorter the *FAD* the better. If a company has high *FAT*, it indicates that the utilization of company's fixed assets is sufficient, and it shows the investment of fixed assets is expedient, the structure of fixed assets are appropriate, the efficiency of fixed assets has reached their full use. On the contrary, if a company has low fixed assets turnover ratio, it indicates that the utilization of fixed assets is low, and the operation ability of company is weak.

This ratio is similar to *CAT*, we can combine these two ratios together when we analyze. Even we expect the turnover ratio be higher, but if these ratios are too high, it won't be good for company. If *CAT* is too low for company, it means the proportion of current assets is too big, the capital has been tied up; and if at the same time the *FAT* of company is too high, it means the amount of fixed assets may be too small, this kind of assets can make larger profit than current assets, so we recommend the company can adjust the proportion between current assets and fixed assets.

2.5.5 Total Assets Turnover Ratio

Total assets turnover ratio is the ratio between *TR* and total assets, this indicator expresses the comprehensive utilization efficiency of total assets, and it also estimates the management quality of company. This indicator has large difference among industries that have various level of capital intensity, for example, in America; heavy industry must have invested more than 1 dollar if they want to generate 1 dollar of sales, in manufacturing industry is around 1 dollar, and in light industry only need invest dozens of cents.

The formulas of total assets turnover ratio can be shown as following:

$$TAT = \frac{TR}{ATA}. \tag{2.24}$$

Where *TAT* is "total assets turnover ratio" and *ATA* is "average total assets". The numeric "average total assets" can be found in the balance sheet.

We can use "total assets turnover in days" to assess in how many days the total assets can convert into cash. It can be calculated as:

$$TAD = \frac{TAT \cdot 365}{TR}. \tag{2.25}$$

Where *TAD* is "total assets turnover in days".

Under normal circumstance, higher *TAT* or shorter *TAD* both indicates the speed of turnover is faster, and the operating ability of the company is stronger. On this basis, the companies should move forward to analyze every component to find the reason why total assets turnover ratio is increasing or decreasing. If the times of total assets turnover are slower, that means the efficiency of using total assets to run business is very low, and it will finally affects the profitability of company. At this time, the company should take actions to enhance the utilization efficiency of assets, and increase revenue or deal with idle assets. The company can use the methods like small profits but quick returns to accelerate the speed of turnover, and make the increase of profits.

2.6 Comparison of Financial Ratio

Most of descriptions are based on the information from Jaffe, Ross and Westerfield (2010).

Financial ratio can provides us a lot of information, but only the ratio is not enough for us to make comprehensive financial ratio analysis. The problem exist behind financial ratio will be found by comparing these ratio with others.

There are many ways of comparison. Firstly, we can do the comparison of same ratio of company between different years. Through this way we can easily find which year did the company running well and which year was in bad condition for company.

The comparison of financial ratio in analyzed company itself can help us realize the company's evolution of financial situation; it can help managers to decide whether the company should improve its condition.

Furthermore, we can use the data from company's competitor or from the industry. This kind of comparison is also important for managers, by comparing the same ratio between company itself and competitor's, managers can realize what level their company is among the industry. Sometimes, the bad condition of company is not caused by internal causes within company itself, but caused by external reasons like the whole industry is in trouble. Under this condition, the comparison of ratio with competitors or industry can help us find the problem.

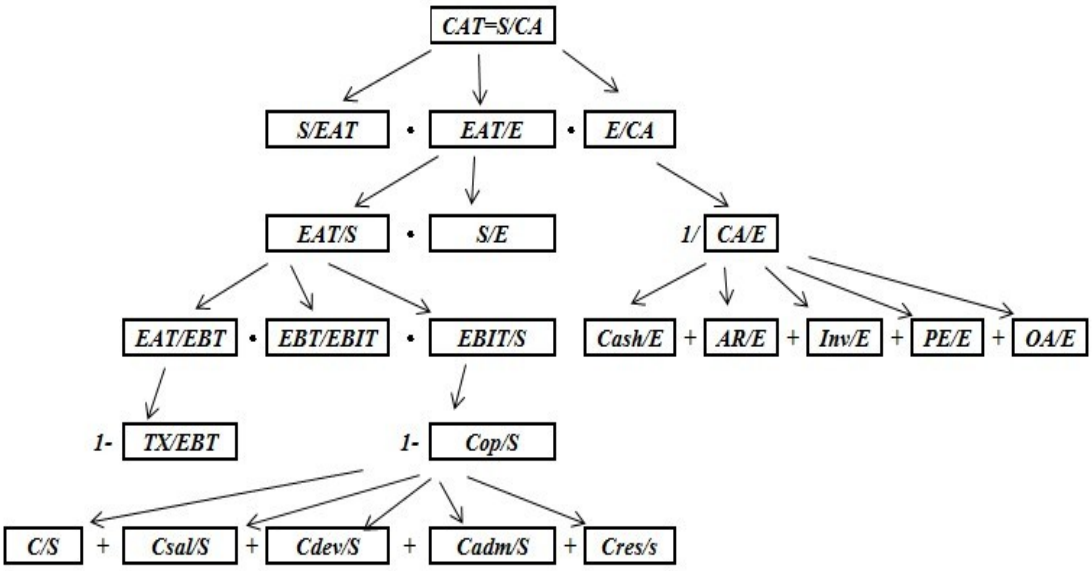
2.7 Description of Pyramidal Decomposition

This chapter is written on the base of the descriptions stated by Dluhosova and others (2004).

Dluhosova and others (2004, p24) states that *"One of the basic tasks for financial analysts is to perform the analysis of increments in synthetic indicators as well as to search for and to qualify factors, which mostly contribute to such changes."* This kind of analysis usually based on the pyramidal system of indicators, the synthetic indicator is the top indicator in the system, and the analysis of top indicators can be calculated in the form of mathematical equations.

For example, indicator *CAT* can be decomposed by various ways, for purpose of this thesis we created the decomposition which is depicted in image 2.1. The pyramidal decomposition of *CAT* in image 2.1 is based on the theory of DuPont analysis with own adjustment. DuPont analysis is the pyramidal decomposition of *ROE*. The decomposition that we made to indicator *"EAT/E"* has been illustrated by Dluhosova and others (2004, p32).

Image 2.1 Pyramidal Decomposition of Current Assets Turnover Ratio



Where *E* represents "equity", *L* represents "liabilities", *A* represents "assets", *CA* and *FA* represents "current assets" and "fixed assets", *CL* and *FL* is "current liabilities" and "non-current liabilities", *S* is "sales", which is equal to the amount of total revenues; *Inv* represents "inventory", *AR* is "accounts receivable", *PE* and *OA* represents "prepaid expenses" and "other assets"; and *EBT* is "earnings before tax", *EBIT* is "earnings before interest and tax", *TX* is "interest tax", C_{op} is "cost", *C* is "cost of goods sold", C_{sal} is "sales cost", C_{dev} is "development cost", C_{adm} is "administrative cost", C_{res} is " rest of operating cost".

The reason why we decompose synthetic indicator into more detailed indicators is that we can find which indicator contributes mostly to the changes of synthetic indicator. We can formulate the total increment as a sum of all components in the following formula 2.26:

$$\Delta y_x = \sum_i \Delta x_{a_i}. \tag{2.26}$$

Where *x* is the top indicator that we analyzed and Δy_x is the increment in the influence of the top indicator, a_i is the indicator that we decomposed from top indicator and Δx_{ai} is the influence of a_i that make on sythetic indicator *x*. For example, the total increment of *CAT* can be explained by particular influences in formula 2.27 as:

$$\Delta CAT = \Delta x^{S}/_{EAT} + \Delta x^{EAT}/_{E} + \Delta x^{E}/_{CA}. \quad (2.27)$$

Additive operations

We can use additive operations to calculate the increment on the influence of each decomposed indicator when the operational symbol between each indicator is plus sign or minus sign. The formula can be expressed as follows:

$$\Delta x_{a_i} = \frac{\Delta a_i}{\sum_i \Delta a_i} \cdot \Delta y_x. \quad (2.28)$$

Where Δa_i is the difference of decomposed indicator i between different period, which can be expressed as:

$$\Delta a_i = a_{i,1} - a_{i,0}. \quad (2.29)$$

Where $a_{i,0}$ is the value of decomposed indicator in the initial period and $a_{i,1}$ is the value of decomposed indicator in the subsequent period.

Multiplicative operations for the Logarithmic Method

The logarithmic method is a simple method for us to calculate the increment on the influence of each indicator when the operational symbol between each indicator is multiplication sign; firstly, we can express the indicators as follows:

$$I_x = \frac{x_1}{x_2} = \frac{a_{1,1}}{a_{1,0}} \cdot \frac{a_{2,1}}{a_{2,0}} \cdot \ldots \cdot \frac{a_{n,1}}{a_{n,0}} = I_{a_1} \cdot I_{a_2} \cdot \ldots \cdot I_{a_n} = \prod_i I_{a_i}. \quad (2.30)$$

Then we can make a logarithmic operation to get following formulas:

$$(\sum_i \Delta x_{ai} / \Delta y_x) \cdot \ln I_x = \sum_i \ln I_{a_i}. \quad (2.31)$$

$$\Delta x_{a_i} = \frac{\ln I_{a_i}}{\ln I_x} \cdot \Delta y_x. \quad (2.32)$$

Although this method is convenient for us to calculate, but there exist a big disadvantage of this method: when the amount of I_{a_i} or I_x is negative, we cannot use logarithmic method to calculate. Under this condition, we can use the gradual change method to calculate the influence.

Multiplicative operations for the Gradual Change Method

We can use the gradual change method to calculate the influence of each decomposed

indicators made on synthetic indicator when logarithmic operation cannot be used, and the influences are quantified without a residue due to formula 2.31as follows:

$$\Delta x_{a_1} = \Delta a_1 \cdot a_{2,0} \cdot a_{3,0} \cdot \ldots \cdot a_{n,0} \cdot \frac{\Delta y_x}{\Delta x},$$

$$\Delta x_{a_2} = a_{1,1} \cdot \Delta a_2 \cdot a_{3,0} \cdot \ldots \cdot a_{n,0} \cdot \frac{\Delta y_x}{\Delta x},$$

$$\ldots$$

$$\Delta x_{a_n} = a_{1,1} \cdot a_{2,1} \cdot a_{3,1} \cdot \ldots \cdot \Delta a_n \cdot \frac{\Delta y_x}{\Delta x},$$

$$\Delta x_{a_i} = \Delta a_i \cdot \prod_{j<i} a_{j,0} \cdot \prod_{j>i} a_{j,1} \cdot \frac{\Delta y_x}{\Delta x}. \tag{2.33}$$

2.8 Summary of Activity Evaluation Methodology

Chapter 2 is the theoretical part of the thesis, all of the financial analysis and activity evaluations we will make in the following chapters are depend on the information in this chapter.

In this chapter, we have introduced the basic purpose and the importance of financial analysis. The financial statements are the data sources for financial analysis, all the data we use for calculating financial ratio are come from financial statements. Common-size analysis, financial ratio analysis and pyramidal decomposition analysis will be the main part of financial analysis and activity evaluation in the thesis.

3. Financial Position Characteristic of GOME Electrical Appliances Holding Limited

The full name of GOME is “GOME Electrical Appliances Holding Limited”; it is one of the largest privately owned electrical appliance retailers in Mainland China and Hong Kong. This company was founded by a Chinese business man named Huang Guangyu.

3.1 The Profile of GOME

In the section, we will discuss about the history of GOME, the business overview of GOME, the main achievements and strategy of GOME and the main competitors, this information can help us learn more about this company.

The major descriptions in this chapter are based on the information from “GOME Electrical Appliance Holding Limited” (2013) and “The Information of SUNING” (2014).

3.1.1 The History of GOME

In 1 January 1987, GOME Group opened its first special retail shop of electrical appliances in Beijing, and this is the sign of foundation of GOME Electrical Appliances Holding Limited. But the brand name “GOME” was first adopted at all its retail outlets in Beijing until 1993, and this is the first version of the evolving retail chain model in China.

In July 1999, GOME had established its first subsidiary out of Beijing in Tianjin, and began its nationwide retail coverage strategy from that time on. In November 2003, the first flagship outlet outside Mainland China was established in Hong Kong, and in August 2004, GOME Group had started exploring another retail format in the form of boutique shops. And GOME Group was successfully listed on the Hong Kong Stock Exchange also in August 2004, and it was the first Chinese home appliance chain retail business listed in Hong Kong.

GOME Group announced a HK$5.2 billion merger with China Paradise in July 2006 and this merger with China Paradise was successfully completed in November 2006. Then in January 31, 2007, the shares of China Paradise were delisted from the Hong Kong Stock Exchange.

Over 25 years of development, GOME Electrical Appliances has more than 1700 direct stores in over 400 cities across China and has a number of excellent national and regional home appliance retail chain brands including GOME, Yongle, Dazhong and Black Swan and so on under its control. And its annual sales have already exceeded 100 billion yuan, and this makes it the biggest home appliance and consumer electronic product chain retailer in China.

3.1.2 The Business Overview of GOME

The core business of GOME Electrical Appliances Holding Limited is retail. GOME belongs to the home appliance retail industry, and its aim is to make a connection between the consumers and suppliers. Consumers will not directly go to the manufactures to buy goods, and GOME is act as a platform for consumers to purchase.

GOME as a pathfinder and leader of China's home appliance retail industry provides customers with products, and these products have the biggest advantages in price and category, and consumption experience compared with other companies in this industry. And it also provides suppliers with a trading form of the most enormous scale effect.

Nowadays, as the network technology in general and the Internet in particular have a rapid development, GOME has not only the brick-and-mortar retailers, but also has developed its online store, and this is another branch of core business of GOME. GOME online mart is the only official online mart of GOME, and it is also a professional and leading online mart among the home appliance retail industry.

GOME online mart depends on its low-price purchase capacity and the convenient purchasing experience for consumers. The advantage of online mart for most consumers is its convenience, consumers can just stay at home and the goods they buy through the online mart will delivery to their house. And GOME online mart sometimes

makes some discounts on special goods to attract more consumers to reach the aim of developing its online mart industry.

3.1.3 The Main Achievements and Strategy of GOME

In 2008, GOME has won "Gold Award of Top 10 Retailers of Retail Asia-Pacific Top 500", and it was among the 25 all-star enterprises listed in "China's Most Admired Companies", and this was the third appearance in this list (three years in a row). GOME was also titled NO.1 in the list of China's retail industry, and becoming the most admired home appliance retail enterprise in China. And it was ranked in the Asia's Fab 500 Companies in 2008 released by Forbes.

In 2011, Deloitte Touche Tohmatsu Limited (America) and STORES Media jointly released the ranking of 250 global retail enterprises, and there were five enterprises from Mainland China among the list, GOME had ranked as the NO.1 home appliance retail chain enterprise in China. And in the list of 2011 Top 30 Global EEO (Electronics, Entertainment and Office) Retailers released by international top retail industry business Planet Retail, GOME had ranked the 11^{th} with total sales of 12.5 billion US dollars, maintained its position as the NO.1 home appliance retail chain enterprise in China.

And in the report of Global Powers of Retailing 2012 jointly released by Deloitte Touche Tohmatsu Limited (America) and STORES Media, GOME was ranked the 74^{th} among the listed 250 retail enterprises around the world.

Today, the whole strategic plan of GOME is to become a respected international retail enterprise with sustainable profitability in the entity retail sales and e-commerce fields.

3.1.4 The Main Competitor of GOME

Nowadays, GOME still attaches its important place in the Chinese market, so in this section we will have a quick look at the main competitor of GOME in Mainland China.

The main competitor of GOME is SUNING Appliance Company Limited, it was founded in Nanjing of China in 1990 and has already listed on the Shenzhen Stock

Exchange in 2004, and this made SUNING Appliance become the first listed Chinese home appliance chain enterprise featured by IPO (Initial Public Offerings), and GOME is the first listed home appliance chain retail business in Hong Kong. And SUNING has 180,000 staff with annual sales revenue 230 billion yuan.

Based on the principle of steady, fast and standardized duplication, SUNING Appliance has formed an overall development pattern integrating renting, building, purchasing and merging. SUNING has over 1600 chain stores in more than 600 cities in Mainland China and in 2009, by overseas merger and acquisition, Suning entered the markets of China Hong Kong and Japan and launching its global business.

And the future prospect of SUNING is the number of brick-and-mortar stores will reach 3500 and the sales volume will reach 35 billion yuan by 2020, at the same time, SUNING will enter the markets of Southeast Asian in 2014 and Western advanced markets in 2016, creating a world-leading service brand. From this side compared with GOME, SUNING has more plans in expansion of overseas sales, but GOME attaches more attention still in the Mainland China's market.

Moreover, SUNING Appliance also persists in the common development of online business, because of the e-commerce platform of SUNING, "SUNING E-go" (the online mart of SUNING Appliance) upgraded in 2010, the product lines have been expanded from home appliance to general merchandise, books and virtual products with the SKU reaching 15,000,000, ranking among China's top 3 B2C companies. GOME also has a strong competition with SUNING in the online area.

3.2 The Description of Basic Data of GOME

In this part we will show the simplified financial statement of GOME, and the financial statements will include the basic data of GOME from 2007 to 2012, unit for all the financial statements is "thousand RMB", from these simplified statements we will have a deeper realize about GOME.

This chapter is based on the information from "GOME's Annual Report" (2013).

3.2.1 The Simplified Balance Sheet of GOME

Based on the structure of balance sheet we introduced in chapter 2.2.1, the simplified balance sheet of GOME is shown in table 3.1.

Table 3.1 The Simplified Balance Sheet of GOME from 2007 to 2012 (unit: RMB'000).

The Balance Sheet						
	2007	2008	2009	2010	2011	2012
Assets						
Cash	6,269,996	3,051,069	6,029,059	6,232,450	5,971,498	6,730,960
Accounts Receivable	3,888,741	5,087,290	1,913,229	2,903,443	4,098,444	2,839,035
Inventory	5,383,039	5,473,497	6,532,453	8,084,971	9,625,044	7,385,352
Prepaid Expenses	6,645,783	4,870,855	8,797,979	6,275,479	4,388,998	6,019,027
Other Financial Assets	150,000					
Total Current Assets	**22,337,559**	**18,482,711**	**23,272,720**	**23,496,343**	**24,083,984**	**22,974,374**
Other Assets		653,423				
Non-current Assets	7,499,934	8,358,970	12,490,460	12,720,919	13,143,484	13,404,255
Total Non-current Assets	**7,499,934**	**9,012,393**	**12,490,460**	**12,720,919**	**13,143,484**	**13,404,255**
Total Assets	**29,837,493**	**27,495,104**	**35,763,180**	**36,217,262**	**37,227,468**	**36,378,629**
Equity and Liabilities						
Accounts Paybles	15,496,240	14,448,099	17,644,775	18,719,682	18,663,698	18,602,980
Accrued Expenses	300,000	170,000	2,530,357	229,976	2,111,610	2,434,374
Current Portion of Debt				97,826		112,480
Income Taxes Payable	383,851	529,148	507,245	509,374	440,905	374,266

Current Liabilities	**16,180,091**	**15,147,247**	**20,682,377**	**19,556,858**	**21,216,213**	**21,524,100**
deferred tax liabilities	80,431	78,269	103,429	111,148	92,961	95,263
convertible bonds	3,184,303	3,569,553	3,174,909	1,814,069		4,953
Non-current Liabilities	**3,264,734**	**3,647,822**	**3,278,338**	**1,925,217**	**92,961**	**100,216**
Total Liabilities	**19,444,825**	**18,795,069**	**23,960,715**	**21,482,075**	**21,309,174**	**21,624,316**
Shareholder's Equity	**10,392,668**	**8,700,035**	**11,802,465**	**14,735,187**	**15,918,294**	**14,754,313**
Total Liabilities &Equity	**29,837,493**	**27,495,104**	**35,763,180**	**36,217,262**	**37,227,468**	**36,378,629**

Source from "GOME's Annual Report" with own adjustment.

The full original version of "Consolidated Balance Sheet" can be found in the Annex 1.

3.2.2 The Simplified Income Statement of GOME

Based on the simplified structure of income statement that we introduced in chapter 2.2.2, the simplified income statement of GOME is shown in table 3.2.

Table 3.2 The Simplified Income Statement of GOME from 2007 to 2012 (unit: RMB'000).

The Income Statement						
	2007	2008	2009	2010	2011	2012
Total Revenues (Sales)	45,449,640	49,596,518	46,140,427	54,690,809	63,523,162	49,849,862
Cost of Goods Sold	-38,383,276	-41,381,223	-38,408,042	-44,991,355	-52,264,259	-41,664,469
Gross Margin	7,066,364	8,215,295	7,732,385	9,699,454	11,258,903	8,185,393
Sales & Marketing	-3,547,907	-4,487,131	-4,352,350	-5,114,303	-6,903,543	-6,803,916

Research & Development	-686,740	-828,028	-845,235	-1,165,138	-1,218,501	-1,423,057
General & Administrative	-604,768	-515,357	-490,062	-375,323	-413,238	-418,717
Other Operating Costs	-193,369	-212,118	-348,969	-441,818	-241,772	-227,708
Operating Expenses	-5,032,784	-6,042,634	-6,036,616	-7,096,582	-8,777,054	-8,873,398
Income From Operations	**2,033,580**	**2,172,661**	**1,695,769**	**2,602,872**	**2,481,849**	**-688,005**
Interest Income	-505,483	-638,812	136,740	-93,340	-7,349	34,011
Profit before tax	**1,528,097**	**1,533,849**	**1,832,509**	**2,509,532**	**2,474,500**	**-653,994**
Income Taxes	**-360,262**	**-435,156**	**-406,310**	**-547,878**	**-673,154**	**-155,997**
Net Income	**1,167,835**	**1,098,693**	**1,426,199**	**1,961,654**	**1,801,346**	**-809,991**

Source from "GOME's Annual Report" with own adjustment.

We can find the full original version of "Consolidated Income Statement" in the Annex 2.

3.2.3 The Simplified Cash Flow Statement of GOME

Based on the simplified structure of cash flow statement that we introduced in chapter 2.2.3, the cash flow statement of GOME is shown in table 3.3.

Table 3.3 The Cash Flow Statement of GOME from 2007 to 2012 (unit: RMB'000).

Cash Flow Statement						
	2007	2008	2009	2010	2011	2012
Beginning Cash Banlance	**1,451,837**	**6,269,996**	**3,051,069**	**6,029,059**	**6,232,450**	**5,971,498**
Profit Before Tax	**1,528,097**	**1,533,849**	**1,832,509**	**2,509,532**	**2,474,500**	**-653,994**
Operating Activities:						
Finance Income	-424,241	-441,017	-341,209	-339,036	-400,291	-441,221

Finance Cost	193,369	212,118	348,969	441,818	241,772	227,708
Loss/(Gain) on Convertible Bonds	505,483	189,220	-203,823	-109,238	7,349	-34,011
Impairment	0	489,317	2,000	0	0	0
Fair Value Gain/(Loss)	-47,326	41,732	83,980	8,517	-15,894	-24,786
Depreciation	256,988	296,256	345,597	332,543	397,217	451,438
Gain/Loss on Other Activities	21,561	23,386	126,981	119,132	63,791	16,818
Increase/Decrease in Deposits, Receivables, Prepayments,and Payables	1,145,113	1,847,831	-1,279,162	2,658,875	501,616	1,856,927
Increase/Decrease in Related Parties	-10,125	21,181	-99,303	3,682	-18,926	180,331
Increase/Decrease in Inventories Or Other Assets	-466,578	59,542	-1,058,956	-1,552,518	-1,522,736	2,239,692
Cash Generated From Operations	2,702,341	4,273,415	-242,417	4,073,307	1,728,398	3,818,902
Interest received	390,864	260,645	507,734	352,953	406,776	608,887
Dividends Paid	-364,311	-661,090			-964,758	
Income Taxes Paid	-168,171	-262,610	-440,023	-553,081	-787,145	-290,523
Net Cash Flow From Operating Activities	**2,560,723**	**3,610,360**	**-174,706**	**3,873,179**	**383,271**	**4,137,266**
Investing Activities:						
Proceeds From Disposal	1,245	15,042	6,555	2,352	83,422	62,235
Acquisition	-19,716	-551,552	0	0	41,835	0
Payment And Prepayment	-10,000	-45,000	-2,760	0	0	0
Other Activities	-3,113,820	-3,933,058	-297,636	-555,287	-861,450	-783,289
Net Cash Flow From Investing	**-3,142,291**	**-4,514,568**	**-293,841**	**-552,935**	**-736,193**	**-721,054**

Activities						
Financial Activities:						
Issue Of Shares, Bonds And Warrants	6,032,306	0	5,232,099	0	0	0
Repurchase Of Bonds, Shares	0	-2,067,557	-1,820,100	0	-14,574	0
Redemption Of Convertible Bonds	0	0	0	-2,685,508	0	-2,598,042
Activities With Bank Loans	-429,330	-130,000	180,000	-250,000	-100,000	-33,633
Other Activities	-71,860	0	-108,602	6,067	296,240	71,746
Interest Paid	-40,789	-16,088	-16,064	-172,524	-74,207	-106,567
Net Cash Flow From Financing Activities	**5,490,327**	**-2,213,645**	**3,467,333**	**-3,101,965**	**107,459**	**-2,666,496**
Net Increase In Cash And Cash Equivalents	**4,908,759**	**-3,117,853**	**2,998,786**	**218,279**	**-245,463**	**749,716**
Cash and cash equivalents at 1 January	1,451,837	6,269,996	3,051,069	6,029,059	6,232,450	5,971,498
Exchange differences	-90,600	-101,074	-20,796	-14,888	-15,489	9,746
Cash And Cash Equivalents At 31 December	**6,269,996**	**3,051,069**	**6,029,059**	**6,232,450**	**5,971,498**	**6,730,960**

Source from "GOME's Annual Report" with own adjustment.

The full original version of "Consolidated Cash Flow Statement" can be found in the Annex 3.

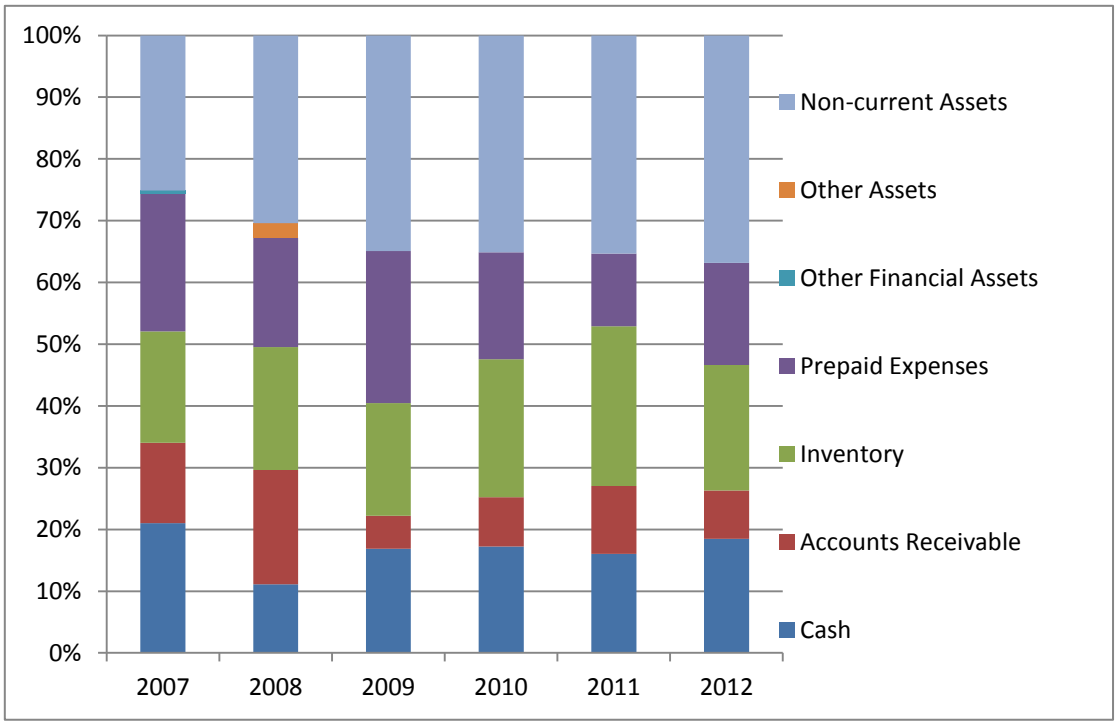
3.3 The Common-Size Analysis of GOME

In this chapter, we will discuss the common size analysis of financial statements of GOME from 2007 to 2012, and this part will include both vertical analysis and horizontal analysis of financial statements.

3.3.1 The Vertical Common-Size Analysis of Balance Sheet

First we will do the vertical analysis to the balance sheet, the balance sheet can be separated into two major parts, total assets and total liabilities and equity, the total amount of these two parts are the same. So we can analysis these two parts separately, and from the chart 3.1 we can see the vertical analysis of total assets.

Chart 3.1 Vertical Common-Size Analysis of Total Assets



In the chart 3.1 we can see the basic structure of total assets, the current assets make the major part of assets, and it makes up of more than 60 percent every year. And GOME holds a certain percentage of cash and cash equivalent every year, this part of assets has highest liquidity, and the company use this funds to meet the basic operating needs and repay for current liabilities, but since cash doesn't make any interest earnings, the company used to keep it at a certain percent like under 20 percent for GOME.

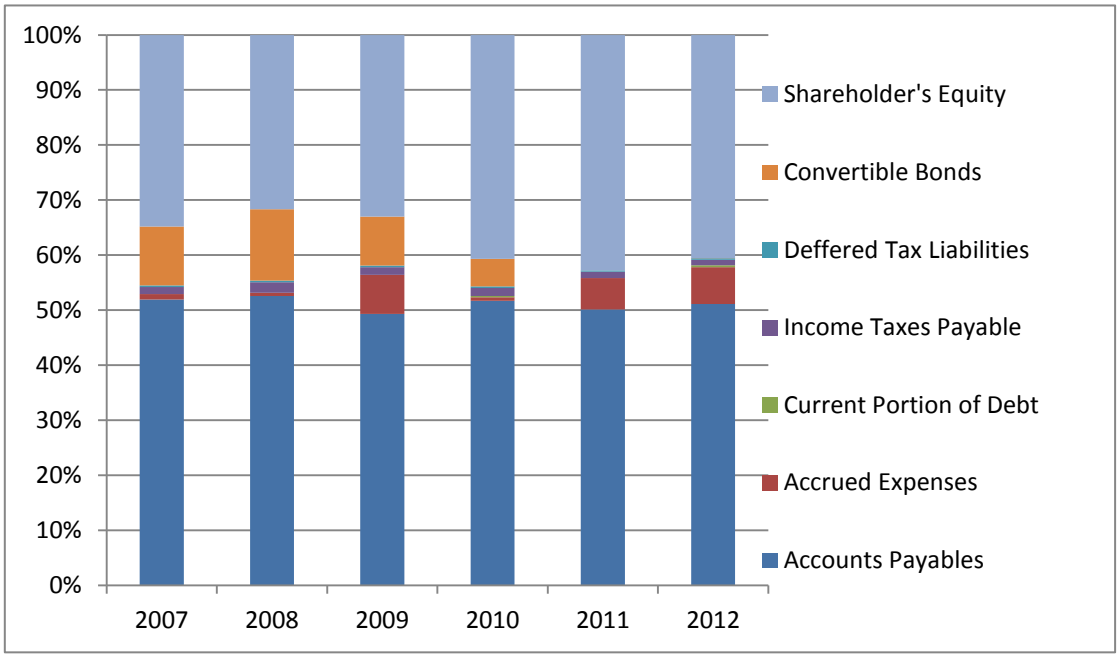
A relatively big part of current assets is inventory, GOME is a home appliance retail company, and it has to hold certain part of inventories to meet the need of customers especially during the peak period. Prepaid expenses are also a large part of current assets, this item refers to the expenses that the company has paid but has not been

benefited. The big company like GOME will have a relatively large number of prepaid expenses for the items like rents for the buildings. Account receivables is another important part of current assets, we can see from the chart 3.1 that this asset are declining its proportion in 2009 into less than 10% of total assets, this is because GOME has implement tight fiscal policy to help improve its account receivables turnover ratio.

And of course the non-current assets are also important for company, company needs to hold this kind of assets to cover long-term obligations, and this kind of assets have higher return than current assets, we can see from chart 3.1 that GOME always holds around 30% of its assets as non-current assets. The amount of fixed assets compared with current assets is very low and GOME has enlarged the amount of fixed assets since 2009 to optimize the assets structure.

In the left side of balance sheet exist "liabilities and equity", whose amount is equal to the total assets, and the chart 3.2 will show the basic structure of total liabilities and equity.

Chart 3.2 Vertical Common-Size Analysis of Total Liabilities and Equity



According to chart 3.2, we can know liabilities have made up of major part of this part in balance sheet, liabilities can be separated into current liabilities and non-current

liabilities, non-current liabilities includes deferred tax liabilities and convertible bonds.

Accounts payable is very important for GOME in current liabilities; we can see from chart 3.2, it makes up about 50 percent of total liabilities and equity every year. Due to the characteristic of home appliance retail industry, GOME will receive many products from different manufacture companies, and before these products are been sold to the customers, they stayed in the company as inventories, GOME will not pay for these inventories to the manufacture companies until they are sold to the customers.

We can see from chart 3.2 that the amount of convertible bonds had kept a certain proportion from 2007 to 2010, but since 2011, GOME has no proportion of convertible bonds. This is because GOME reduced overall liabilities to improve its debt to total equity ratio from 2010 and GOME has redeemed and converted all its convertible bonds at the end of 2010.

3.3.2 The Vertical Common-Size Analysis of Income Statement

The vertical analysis of income statement is kind of different; we can have basic structure of income statement in table 2.2 before, and we can find that there are some expenses are negative in the number, in order to analyze the structure more convenient, we turn these numbers into positive and keep the amount the same. We take *TR* as 100 percent, and the basic item is *CG*, total operating expenses, interest, income taxes and net income. We just use *TR* as benchmark, and follow the formula 2.2, we can use every item compared with the same benchmark to helps us have a better realize about income statement. To analyze the component more visual, we can use the chart 3.3.

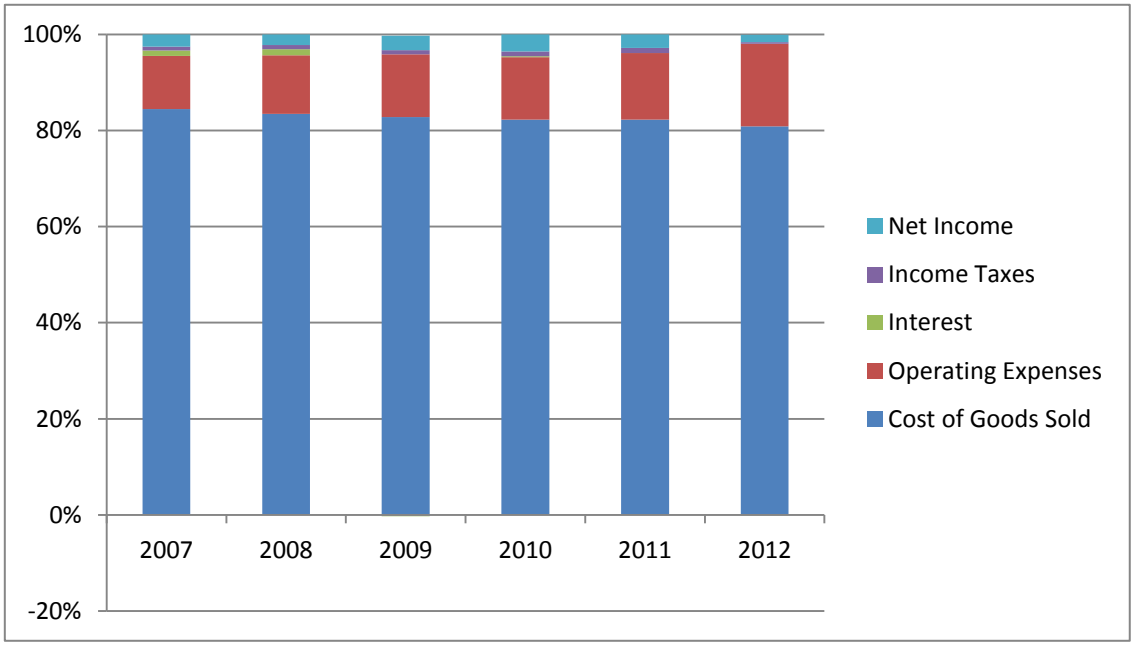
From the chart 3.3, we can find out that the amount of *CG* can reach at least 80% compared with each year's revenues for GOME, but we should realize that the *CG* is negative for a company, because it is the money that company must pay to others. For the appliance retail company like GOME, the cost of goods sold refers to the cost of buying in products as inventories from product companies.

The operating expenses and net income have also relatively big proportion compared

with revenues in each year. Operating expenses include the expenses on sales and marketing, research and development, general and administration; for GOME, these expenses is relatively high because the company need pay for the transportation both from product company to its storeroom and from its storeroom to customers' houses, and the advertisement is also important for a retail appliance company like GOME, they need these expenses for their further development.

The proportion of income taxes and interest is controlled by the government; company cannot change the amount of these items. In 2012, the percentage of these items compared with revenues decreased into approximately 0%, this is because GOME has made loss in 2012. The lower income company generate, the lower tax company need to pay.

Chart 3.3 Vertical Analysis of Revenues in Income Statement

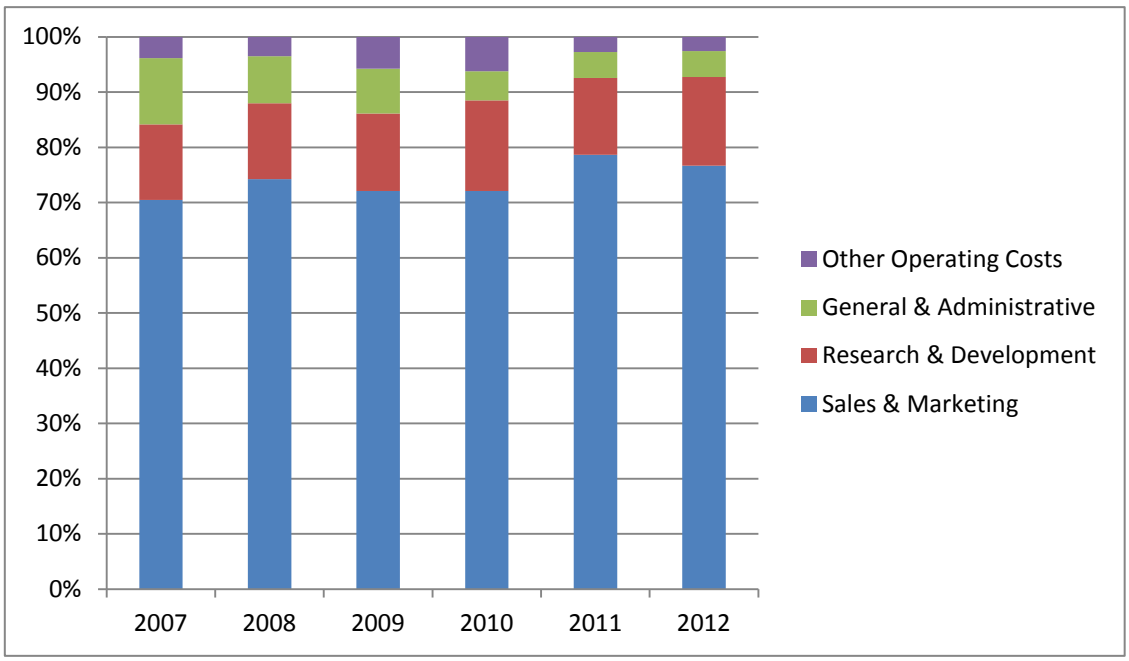


In order to analysis the income statement more clearly, we use the total operating expenses as 100 percent, and from chart 3.4 we can figure out which kind of operating expenses make up the biggest part of operating expenses.

Seen from chart 3.4 we can know the sales and marketing expenses are made up of the biggest proportion of operating expenses, this part of expenses cannot be easily decreased because of the condition that GOME has been expanding its structure since

2007. We can also find that the research and development expenses also is a big part of operating expenses, this phenomenon shows that GOME is working hard to meet the customer's demand and to find out the most suitable way for them to develop.

Chart 3.4 Vertical Analysis of Operating Expenses in Income Statement

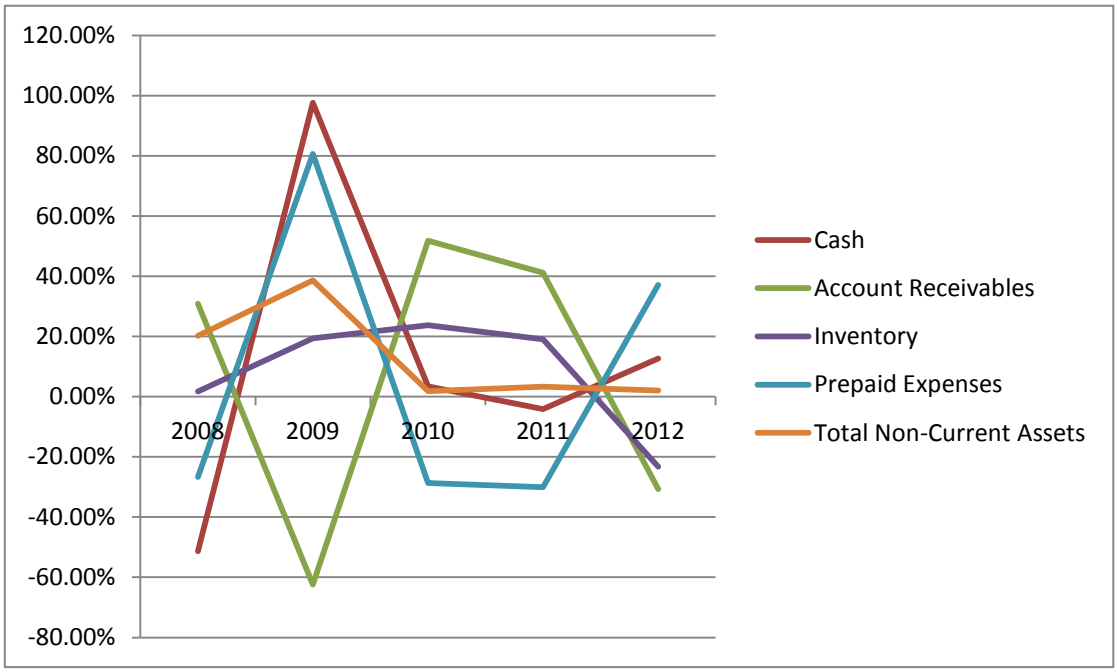


3.3.3 The Horizontal Common-Size Analysis of Balance Sheet

In the horizontal common-size analysis in this thesis, we always use the previous year of every year as a benchmark, so the horizontal analysis will show the change in every item from 2008 to 2012.

Compared with other items in the assets, inventory tends to have a gently change from 2009 to 2011, as a retail appliance company, GOME has to always keep a certain amount of inventories to meet the customers' demand. The increasing from 2008 to 2009 is because GOME has implement "appliance and electronics rebates for consumers in the countryside" policy, which stimulating consumption and increasing the consumer demand. The decreasing of inventory from 2011 to 2012 is because aggressive monetary tightening measures has taken off and the growth of China's macro economy is beginning to slow down; the macroscopic reasons cause the decreasing of consumer demand, and lead to the decreasing of inventory.

Chart 3.5 Horizontal Analysis of Assets in Balance Sheet



The amount of cash changes very widely during 2008 to 2010, this asset is used for selling need and paying the current liabilities; the amount of cash is related to the cash expenses and cash income. In 2008, considered of the low interest rate of deposit caused by subprime crisis, GOME has decrease approximately 50% of cash compared with 2007. In 2009, because of the recovery of macro economy and the implementation of "appliance and electronics rebates for consumers in the countryside" policy, GOME has increased its amount of cash by 100% compared with 2008. In 2010, the amount of deposit of GOME has decreased sharply compared with 2009; this is because GOME has closured many retail stores with low profit to optimize its market structure.

Prepaid expenses also change a lot, this item refers to the expenses that have been paid and can be apportioned to the future period. In 2009, GOME has acquired 10% of stock rights of China Paradise Electronics Retail Company, which increased prepaid expenses by 80% compared with 2008. The increasing of prepaid expenses in 2012 is because GOME has made the prepayments of acquisition of properties.

Account receivables act in different tendency with other items. In the beginning of 2009, GOME has received the administration expenses from Dazhong Electrical Appliance, which decreased account receivables by 60% at the end of 2009 compared

with 2008. The increasing of accounts receivables in 2010 can be mainly attributed to the aggregate amount of compensation that should be paid by Wuhan Yinhe Property Co., Ltd. In the beginning of 2012, GOME has received the compensation from Yinhe, which decreased the account receivables at the end of 2012.

Chart 3.6 Horizontal Common-Size Analysis of Liabilities and Owner's Equity

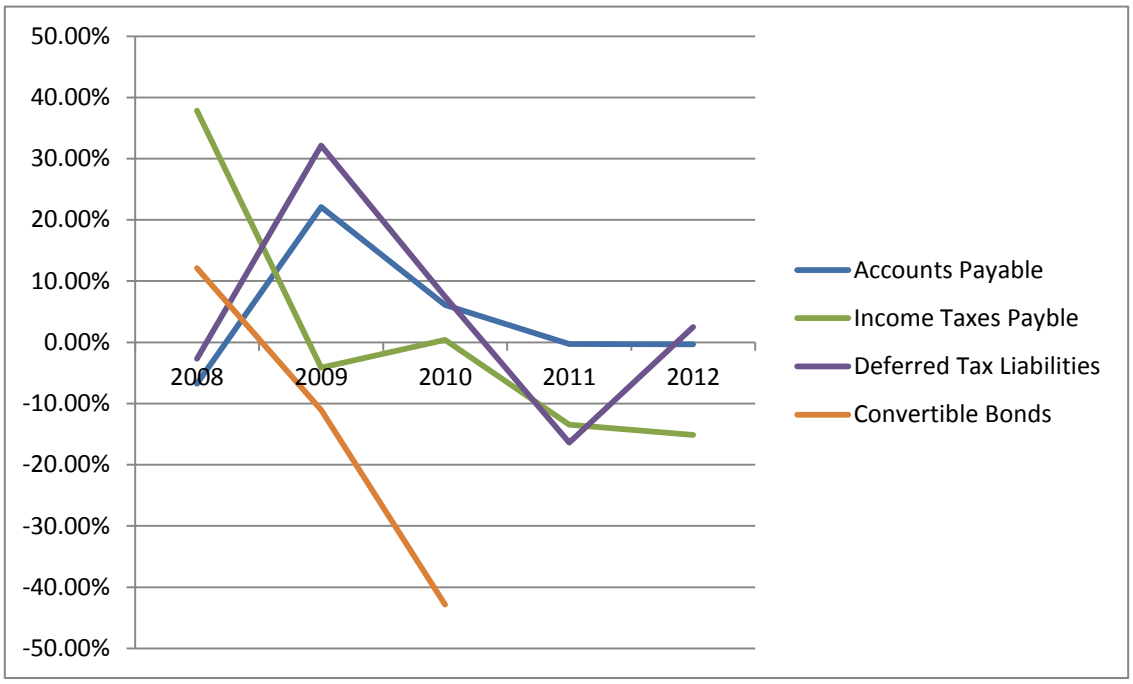


Chart 3.6 shows the horizontal common-size analysis of liabilities and owner's equity in the balance sheet. In chart 3.6, we can see the tendency of income taxes payable, the amount of this item is controlled by the government; company cannot change the amount of income taxes payable itself.

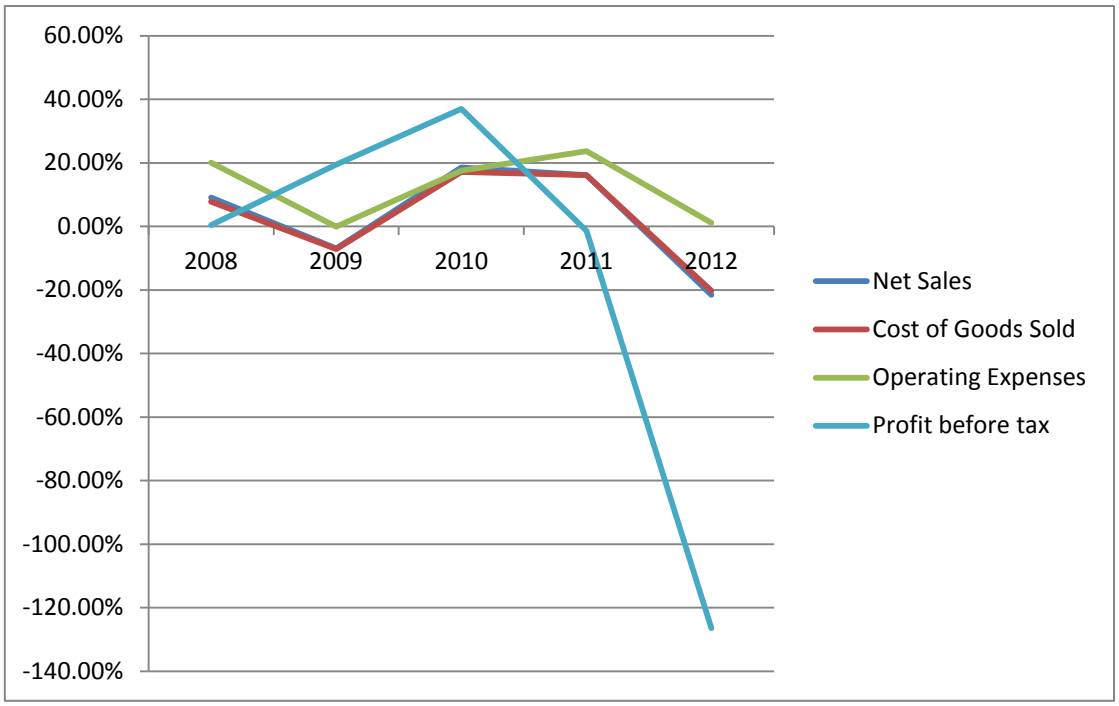
The tendency of convertible bonds from 2009 to 2010 decreased sharply. In 2009, Bain Capital Glory Limited subscribed to 5% coupon convertible bonds due in 2016 issued by GOME, which caused the decreasing of convertible bonds in 2009. In 2010, in order to reduce GOME's overall liabilities to improve its debt to total equity ratio, GOME has redeemed and converted its convertible bonds; this is the reason for decreasing of convertible bonds in 2010.

The amount of account payable has increased by more than 20% compared with 2008, this is because GOME has acquired 10% of stock rights of China Paradise Electronics Retail Company and has left residual payment.

3.3.4 The Horizontal Common-Size Analysis of Income Statement

In this part, we will show the general graph to help us have a clear understand of change tendency of important items.

Chart 3.7 Horizontal Analysis of Income Statement



The tendency of net sales and cost of goods sold are almost coincided, and they changes rarely compared with the change of profit before tax.

In 2009, GOME has gained on repurchasing of the old 2014 convertible bonds, which increased the profit before tax by approximately 20% compared with 2008. In the end of 2009, GOME has entered into a management agreement with Beijing Zhansheng Investment Co., Ltd. According to the agreement, GOME manages and operates the retailing business of Beijing Dazhong Home Appliances Retail Co., Ltd for management fees, which increased the profit before taxes in 2010 by 36% compared with 2009. In 2012, the transition of China's economy from a high growth phase to steady growth phase has put pressure on GOME and GOME has made loss.

3.4 Summary of Financial Position Characteristics of GOME

Chapter 3 has provided the basic information of GOME, which including its history, background and competitor. The financial position characteristic is shown in the simplified financial statements and common-size analysis towards balance sheet and income statement.

From the common-size analysis, we can know GOME has made loss in 2012, most of the items change widely from year to year, this means GOME did not find the most suitable proportion of these items. In order to make financial analysis and activity evaluation of GOME, we need to calculate the financial ratio and make pyramidal decomposition analysis.

4. Analysis of Activity of the Selected Company

According to the data in financial statements and methods we introduce before, we will analyze the financial situation in this section of bachelor thesis.

4.1 Financial Ratio Analysis

In order to analyze the financial situation of GOME comprehensively, we should analyze the financial ratios; it includes profitability ratio, liquidity ratio and solvency ratio. In this section, we will give brief comments of these ratios.

4.1.1 Analysis of Profitability Ratios

We choose return on equity (*ROE*) and return on assets (*ROA*) to help us to analyze the profitability of GOME.

Return on Equity (ROE)

ROE measures the company's efficiency on generating profit from every unit of shareholder's equity.

Table 4.10 ROE of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	0.11	0.13	0.12	0.13	0.11	-0.05
SUNING	0.30	0.23	0.17	0.20	0.19	0.08

Seen from the table 4.10, compared with SUNING, GOME has lower *ROE*, but GOME keeps a stable condition from 2007 to 2011, and the negative number in 2012 is because GOME has made loss in that year. With the reality that the scale of GOME is smaller than the scale of SUNING, the ability to generate profit of GOME is lower than SUNING is a kind of normal condition. This is mainly because the management system and customer resources of small company are not as perfect as big company.

In order to improve this ability, GOME should decrease its proportion of equity while generating the same amount of money.

Return on Assets (ROA)

ROA measures the ability to generate profit from assets.

Table 4.11 ROA of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	0.04	0.04	0.04	0.05	0.05	-0.02
SUNING	0.09	0.09	0.07	0.08	0.07	0.03

Similar as *ROE*, *ROA* of smaller company can't be in the same level of bigger company, and for those industries that need larger initial investment, it usually has lower *ROA*. For GOME, its *ROA* compared with SUNING is much lower, from the analysis of *ROE* and *ROA*; we can see that GOME is not working well with its profitability, the efficiency that use investment to generate profit is very low.

In order to solve this problem, GOME should find in which link of operating is weak for company, there must have some problem in operating, it can because the cost is too high or the demand is too low, it can also because price of products is too high so that the company is not competitive as other companies in the industry.

4.1.2 Analysis of Liquidity Ratios

Current Ratio

Current ratio measures whether company can meet its current obligation.

Table 4.12 Current Ratio of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	1.38	1.22	1.13	1.20	1.14	1.07
SUNING	1.18	1.33	1.36	1.31	1.14	1.24

The *CR* of GOME and SUNING stays in a relatively stable level, this indicator measures the ability of a company to pay back the short-term debt. Seen from table 4.12, we can tell that the liquidity of GOME and SUNING are almost the same, and from 2007 to 2012, this indicator keeps stable, it is in a good situation for companies.

Quick Ratio

The difference between *CR* and *QR* is *QR* ignores inventories and prepaid

expenses.

Table 4.13 Quick Ratio of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	0.64	0.54	0.38	0.47	0.47	0.44
SUNING	0.65	0.71	0.88	1.01	0.83	0.75

We can see from table 4.13, SUNING and GOME has a much different numbers in *QR* though they have almost the same number in *CR*. This tells us two companies have different proportion in every item of current assets. If the *QR* of a company is lower than 1, it means the company can't fully pay back it current liabilities in time, and if this condition continues, the company will not running well.

As we analyze before, GOME has keep a large amount of inventories in current assets, and this made GOME's *IT* is lower than SUNING, we can see the problem in both liquidity and profitability. Inventories don't generate money; too many inventories overstocked will lead to low liquidity and profitability.

4.1.3 Analysis of Solvency Ratios

The important solvency ratios are debt-to-assets ratio and debt-to-equity ratio; these two indicators measure the financial leverage of a company by calculate how much the assets are financed by debt and how much the equity is financed by debt.

Debt-to-assets Ratio

Debt-to-assets ratio measure the financial risk of company.

Table 4.14 Debt-to-assets Ratio of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	0.65	0.68	0.67	0.59	0.57	0.59
SUNING	0.71	0.60	0.61	0.60	0.66	0.66

From table 4.14 we can know, this ratio of GOME and SUNING is of the same level. The higher the *D/A*, the greater the financial risk of the company, and this ratio differs from industry to industry. GOME and SUNING both keep this ratio around 0.6;

it indicates that this level if good for company and can keep the companies running healthily.

Debt-to-equity Ratio

The difference between *D/A* and *D/E* is that they measure different items to total obligation and show the different leverage.

Table 4.15 Debt-to-equity Ratio of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	1.87	2.16	2.03	1.46	1.34	1.47
SUNING	2.48	1.49	1.57	1.47	1.93	1.94

GOME and SUNING has different *D/E*, this can be caused of the equity of the companies differs widely. The proportion of equity is not as big as the proportion of assets, the *D/E* will be much higher than *D/A*. Since these two indicators connected with the leverage, managers should keep an eye on these indicators.

4.2 Activity Ratio Analysis

This thesis will lay emphasis on the activity ratio analysis of GOME, as we introduced before, the formulas in chapter 2.5 are used to calculate activity ratios.

4.2.1 Receivable Turnover Ratio

Receivable turnover ratio is used to measure how many times of receivables converted into cash. The *RT* of GOME and its competitor, SUNING, from 2007 to 2012 will be shown in table 4.1.

A higher *RT* means that the company has the ability to get the receivables faster, and the *RD* are shorter, the bad debt losses will be fewer and short-term debt paying ability is stronger.

We can know from the formula 2.16 that *RT* is connected with *TR* in numerator and *AAR* in denominator, the increase of *RT* can be caused by the increase of *TR* or the decrease of *AAR*; and the decrease of *RT* can be cause by the decrease of *TR* or the

increase of *AAR*. Seen from the table 4.1, *RT* of GOME keeps changing over years but it is in the range from 10 to 20, in order to find out whether this range is normal or not, we use the data from its competitor, SUNING to do a comparison, and in order to make this data easier to understand, we will exchange its form into *RD*, and from *RD* we can easily find out in how many days the receivables can be turnover once.

Table 4.1 Receivable Turnover Ratio of GOME and SUNING

Indicators	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
GOME	16.67	11.05	13.18	22.71	18.14	14.37
Changes	-	-33.72%	19.28%	72.27%	-20.10%	-20.80%
SUNING	43.05	32.07	41.03	32.64	15.26	10.37
Changes	-	-25.51%	27.94%	-20.45%	-53.25%	-32.04%

Before 2011, SUNING had much shorter *RD* than GOME, as we talked before, shorter *RD* is better for a company, but if this indicator is too low, it shows the terms of payment may be too harsh and will limit the enlarge of sales volume, so we can see in 2011 and 2012, SUNING had increased its *RD* to around 30. From the comparison we can tell that GOME has a normal receivable turnover ratio, this is good for the company, and the ratio at the level can both keep the company running well and have the enough ability for company to enlarge its scale.

Table 4.2 Receivable Turnover Days of GOME and SUNING

Indicators	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
GOME	21.89	33.03	27.69	16.07	20.12	25.40
SUNING	8.48	11.38	8.90	11.18	23.92	35.19

4.2.2 Inventory Turnover Ratio

Inventory is important current assets for home appliance retailers like GOME, and inventory turnover ratio measures the efficiency of using inventory. The *IT* of GOME and SUNING from 2007 to 2012 is shown in table 4.3

Table 4.3 Inventory Turnover Ratio of GOME and SUNING

Company	2007	2008	2009	2010	2011	2012
GOME	7.48	7.62	6.40	6.16	5.90	4.90
Changes	-	1.94%	-16.07%	-3.79%	-4.12%	-17.00%
SUNING	9.63	9.37	8.38	7.58	6.76	5.50
Changes	-	-2.70%	-10.57%	-9.55%	-10.82%	-18.64%

For a home retail appliance company, inventories make up of a large part of current assets, if a company have high *IT*, it means the company have low occupied level of inventories and high liquidity, the speed of inventories convert into cash and account receivables will also be high. The level of inventory turnover also influence short-term debt paying ability, *IT* lead to stronger ability to pay the short-term debt.

Compared with SUNING we can know that the *IT* of GOME is not high, there must have some problem during its sale processes so that the products can't be sold quickly and have to stay in the factory as inventories. Even the change in inventory turnover ratio seems to be very rare, but if we turn these data into *ID*, we can easily see some different.

Table 4.4 Inventory Turnover Days of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	48.81	47.88	57.05	59.29	61.84	74.51
SUNING	37.91	38.94	43.54	48.13	53.98	66.34

We can see from table 4.4 that if GOME wants to accomplish a turnover of inventories, it needs nearly 10 or 15 days more than SUNING. During this period, the products stay in the factory with no return, and they cost storage fees, this can be a big amount of loss of company in accumulate.

Even the ratios of GOME seem to be stable from year to year compared with receivable turnover ratio, but *ID* of GOME has been facing increasing since 2008, the increase of *ID* can be caused by decrease of *CG* or increase of *AI* according to formula 2.19.

For GOME, to keep the *IT* stable and keep the company running well, they should adjust the correct relationship between inventories and need of customers. Under the conditions that the customers' needs are very low, the company doesn't need to store too many inventories, and they can save a part of storage fees for other use.

4.2.3 Current Assets Turnover Ratio

Current assets turnover ratio is used to measure the speed of current assets turnover, the *CAT* of GOME and SUNING from 2007 to 2012 is shown in table 4.5.

Table 4.5 Current Assets Turnover Ratio of GOME and SUNING

Company	2007	2008	2009	2010	2011	2012
GOME	2.40	2.43	2.21	2.34	2.67	2.12
Changes	-	1.14%	-9.05%	-5.82%	-14.17%	-20.65%
SUNING	3.76	3.06	2.27	2.24	2.25	1.76
Changes	-	-18.62%	-25.82%	-1.32%	0.45%	-21.78%

If a company has high *CAT*, it means company will have better efficiency on using current assets. According to formula 2.20, the level of *CAT* is connected with the *TR* on numerator and the *ACA* on denominator, if *CAT* increase, it can be caused by increase of *TR* or decrease of *ACA*; if the *CAT* decrease, it can be caused by decrease of *TR* or increase of *ACA*.

From 2007 to 2009, SUNING had higher *CAT* than GOME; it shows SUNING has better ability in using its current assets. Compared with competitor, we can tell the *CAT* of GOME is maintaining in a normal level, but to make company running better, GOME should keep an eye on its production and operation, the weakness of operation in GOME is shown also in inventories. Just compared two companies may not make the problem clearly, if we turn this data into *CAD*, we can see the problem of both two companies.

As we all know, current assets have high liquidity but it makes almost no profit, seen from table 4.6, for both of two companies, they have to take no less than 100 days to accomplish once turnover, and more common condition is that they both need

around 150 days to accomplish once. If a company can accomplish its current assets turnover just twice in a year, it means that the liquidity is low; this is not good for a company. For home appliance retailer, they need a large amount of cash in hand and inventories to meet consumer demand, but if they can't find the balance of cash level and inventories amount, these items can be a huge burden of company.

Table 4.6 Current Assets Turnover Days of GOME and SUNING

Indicators	2007	2008	2009	2010	2011	2012
GOME	151.92	150.21	165.16	156.07	136.70	172.28
SUNING	97.20	119.22	160.80	163.00	162.28	207.01

For GOME, managers should keep an eye on the proportion of current assets, they should keep the inventories and cash not too much and do not just keep the money in hand, but use the income to do some investment to get more profit.

4.2.4 Fixed Assets Turnover Ratio

Fixed assets turnover ratio measures the times of fixed assets turnover, the *FAT* of GOME and SUNING from 2007 to 2012 is shown in table 4.7.

Table 4.7 Fixed Assets Turnover Ratio of GOME and SUNING

Company	2007	2008	2009	2010	2011	2012
GOME	6.90	6.01	4.29	4.34	4.91	3,76
Changes	-	-12.90%	-28.56%	1.10%	13.22%	-23.54%
SUNING	21.98	13.47	9.88	8.53	6.63	4.73
Changes	-	-38.72%	-26.65%	-13.66%	-22.27%	-28.66%

FAT is a little different from current assets turnover ratio. When we analyze the level of fixed assets turnover ratio, it shouldn't be as high as possible, although in general is better when it becomes higher, but the *NVFA* will decrease as depreciation increase, which will affect the speed of fixed assets turnover. It means maybe the *FAT* of company is really high due to the low average *NVFA*, but the value of fixed assets may not be very low because of the high depreciation.

Similar with other activity ratios, high *FAT* is better for company, because it means the utilization of fixed assets is sufficient. Different with current assets, fixed assets has higher return, and high *FAT* shows the investment of fixed assets is reasonable and the structure of fixed assets is appropriate, the efficacy of fixed assets has reached their full use.

Compared two companies, we can find that *FAT* of GOME is low, this indicator of SUNING even reach 20 in 2007, although it decreasing rapidly in the following years to around 10. All these activity ratios of GOME tend to be more stable than SUNING, maybe the data is not high but it doesn't change vary widely, and this shows the stable environment in the company also. Although high activity ratios are good for company, but a stable condition is also important for normal operation and financial condition of company.

Table 4.8 Fixed Assets Turnover Days of GOME and SUNING

Indicators	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
GOME	52.92	60.76	85.05	84.13	74.31	97.19
SUNING	16.61	27.09	36.94	42.78	55.03	77.13

If we compared *FAD* with *CAD*, we can find that for two companies, *FAD* is shorter than *CAD*. In general, the liquidity of current assets should be much higher than fixed assets, but it doesn't reflect on turnover days as well. We can find the reason in the formula 2.21 and formula 2.23, for these two indicators, the denominator is the same, and the quality of indicators is depend on the numerator. The proportion of current assets is much bigger than the proportion of fixed assets, and this leads to the long *CAD* and relatively short *FAD*.

For GOME, it is very important to keep the proportion of current assets and fixed assets balanced. GOME should decrease its current assets appropriately and invest more money in fixed assets to generate more profit; this is not only good for company's liquidity but also can help company make more profit.

4.2.5 Total Assets Turnover Ratio

Total assets turnover ratio measures the utilization efficiency of total assets, and the *TAT* of GOME and SUNING from 2007 to 2012 is shown in table 4.9.

Table 4.9 Total Assets Turnover Ratio of GOME and SUNING

Company	2007	2008	2009	2010	2011	2012
GOME	1.78	1.73	1.46	1.52	1.73	1.35
Changes	-	-2.90%	-15.68%	4.17%	13.83%	-21.70%
SUNING	3.21	2.49	1.85	1.77	1.68	1.28
Changes	-	-22.43%	-25.70%	-4.32%	-5.08%	-23.81%

In general, high *TAT* is good for company; it means the utilization efficiency that company use total assets to run business is strong and if has low *TAT*, the company might has profitable problem.

The *TAT* level of retail home appliance industry in China differs from each year, but it keeps in the range from 1 to 2, and we can see from the table 4.9, GOME has a normal *TAT* among its industry, and SUNING seems to have higher data in 2007 and 2008. Although *TAT* of GOME is decreasing a lot in 2012, but it still keeps in the normal level, this show GOME has the ability to use its assets to support its normal operation.

The normal *TAT* means that the proportion of *TR* to total assets is suitable for GOME, but as we talked before, the company should watch out the proportion of component in total assets under the condition that keep the *TAT* at a normal level.

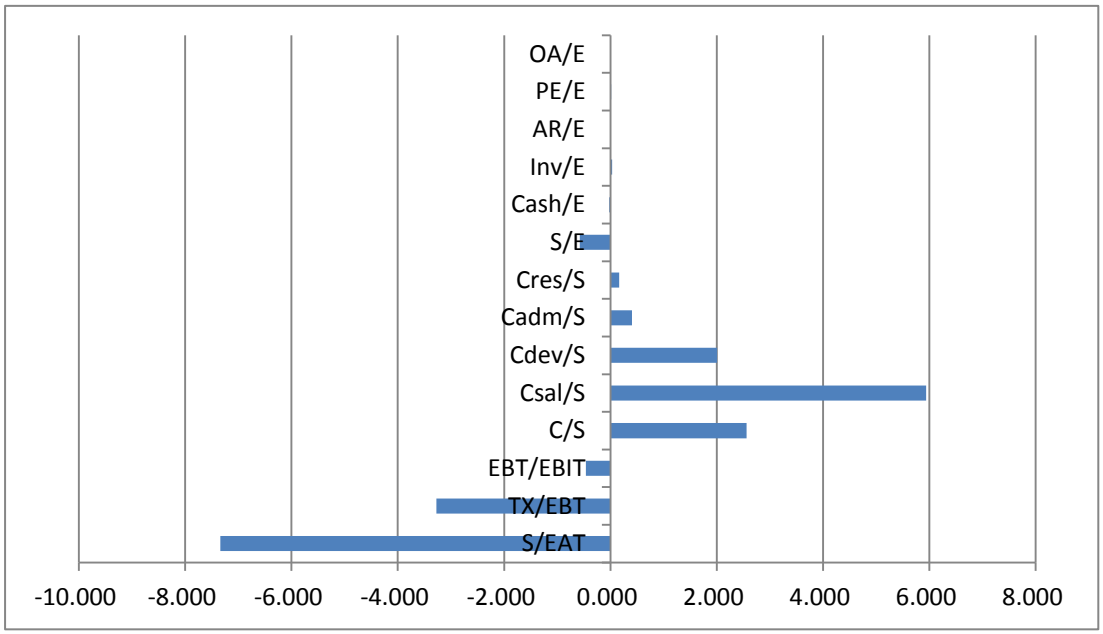
4.3 Analysis of Pyramidal Decomposition

The pyramidal decomposition analysis helps us find out which indicator influence the synthetic mostly and it can give us some ideas about how to improve the current condition and make company running well.

4.3.1 Current Assets Turnover Ratio

We will take *CAT* as an example first. According to chart 2.6, we can calculate the amount of these decomposed indicators from 2007 to 2012, and we will get the influence that every indicators influences on the increment of synthetic indicator. We will choose period from 2011 to 2012 to analyze, this is the most recent data and is most useful for managers to make improvement. The results in chart 4.1 are calculated by the gradual change method and additive operations.

Chart 4.1 Influences of Decomposed Indicators of *CAT* from 2011 to 2012



From chart 4.1 we can know *S/EAT*, *TX/EBT* and *S/E* has the most bad influence on *CAT*, we should try to improve the level of these indicators to increase *CAT*. In order to figure out what adjustment should managers make to help GOME runs well, we can change the amount of these indicators to see how it will influence on the synthetic indicator.

Firstly, we can increase sales by 5%, one thing we should keep in mind is that when we change the sales; it will also influence *EAT*, because of the relationship between balance sheet and income statement, if the net profit is increasing, the owner's equity will also increase. And due to the basic relationship in the balance sheet, if equity is

increasing, assets should also increase. In this case, we can have two different results, if we increase current assets, for example cash, because of the denominator of *CAT* are current assets, and we cannot predict whether it is good for company. After the calculation we can prove that if we increase the amount of sales and current assets at the same time for same amount, the *CAT* will decrease; this cannot help GOME to improve *CAT*. So we will increase the amount of fixed assets, for example the investment, under this condition, *CAT* will increase.

Table 4.16 Adjustment of Decomposed Indicators of *CAT*

Changes(%)	**⊿Sales**	***⊿CAT***	**⊿Equity**	***⊿CAT***
15%	7,487,683	-0.230	2,300,446	-0.738
10%	4,991,788	-0.336	1,533,630	-0.678
5%	2,495,894	-0.443	766,815	-0.616
0%	0	-0.549	0	-0.549
-5%	(2,495,894)	-0.655	(766,815)	-0.477
-10%	(4,991,788)	-0.761	(1,533,630)	-0.401
-15%	(7,487,683)	-0.867	(2,300,446)	-0.319

(Unit for ΔItem is RMB'000)

For indicator *TX/EBT*, we cannot change the amount of taxes because it is controlled by the government. We can also improve this indicator indirectly by increasing the amount of sales.

If we want to improve *S/E*, we can increase sales, and we can also decrease the amount of equity. When equity decreases, assets should also decrease. If we decrease 5% of equity, we should decrease the same amount of assets, for example, when we decrease 5% of equity, the ⊿*CAT* will increase approximately 0.07.

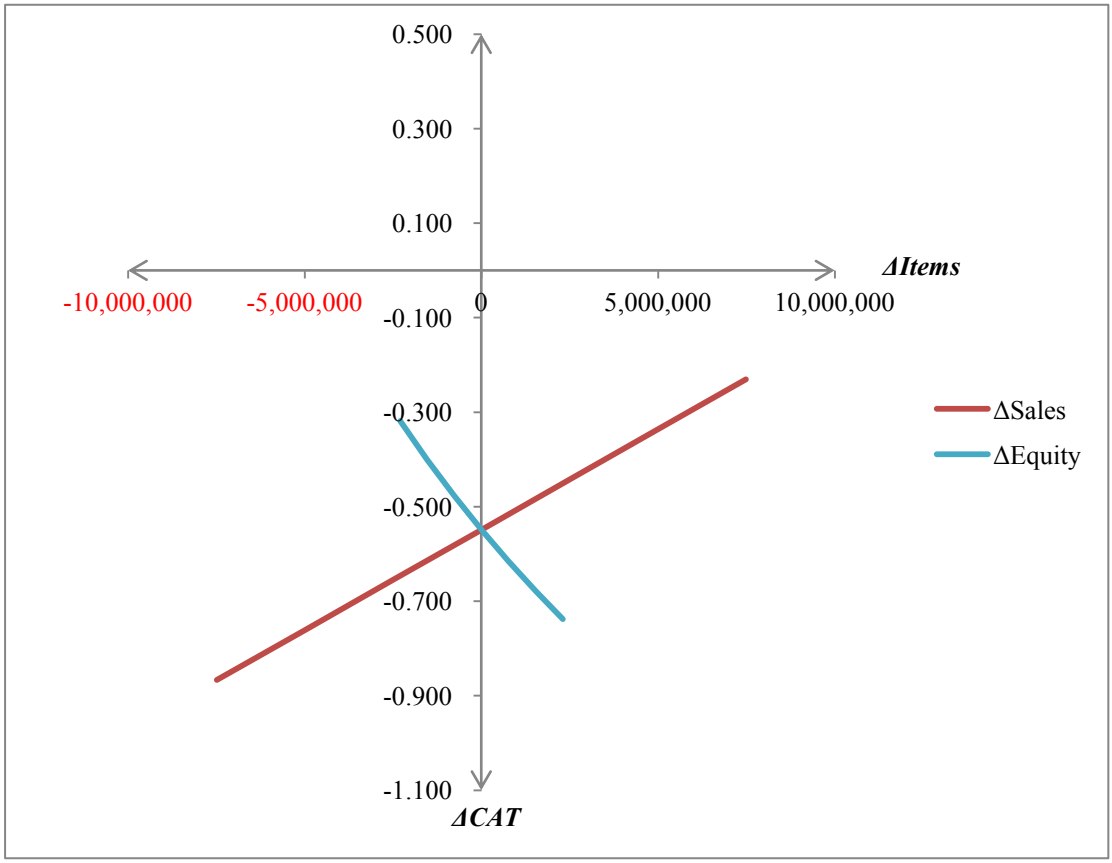
From the data in table 4.16, we can turn it into chart 4.2, which is more readable. In chart 4.2, we can find out a problem that the ⊿Equity is not linear, this is because the change of equity cannot influence *CAT* directly. The influence that ⊿Equity make on *CAT* is brought into effect through the change in current assets. The base amount of equity and current assets is not equal; if we increase equity by 5%, the amount of current assets will also increase by the same amount, but this amount is not 5% of the current asset, which make the curve of ⊿Equity is not linear. For ⊿Sales, because

of formula 2.20, the change of sales can directly influence *CAT*, the ⊿Sales shows a linear trend.

From chart 4.2, we can find out both the decreasing of equity and increasing of sales can help improve the ⊿*CAT*. But the slope of ⊿Equity is bigger than ⊿Sales, which means the efficiency of improving ⊿*CAT* by decreasing one unit of equity is higher than increasing one unit of sales. And it is also easier for GOME to decrease equity than increase the amount of sales.

Based on the analysis above, we suggest managers to decrease certain amount of equity to improve the current assets turnover ratio. This is the most convenient and efficiency way to improve *CAT* of GOME.

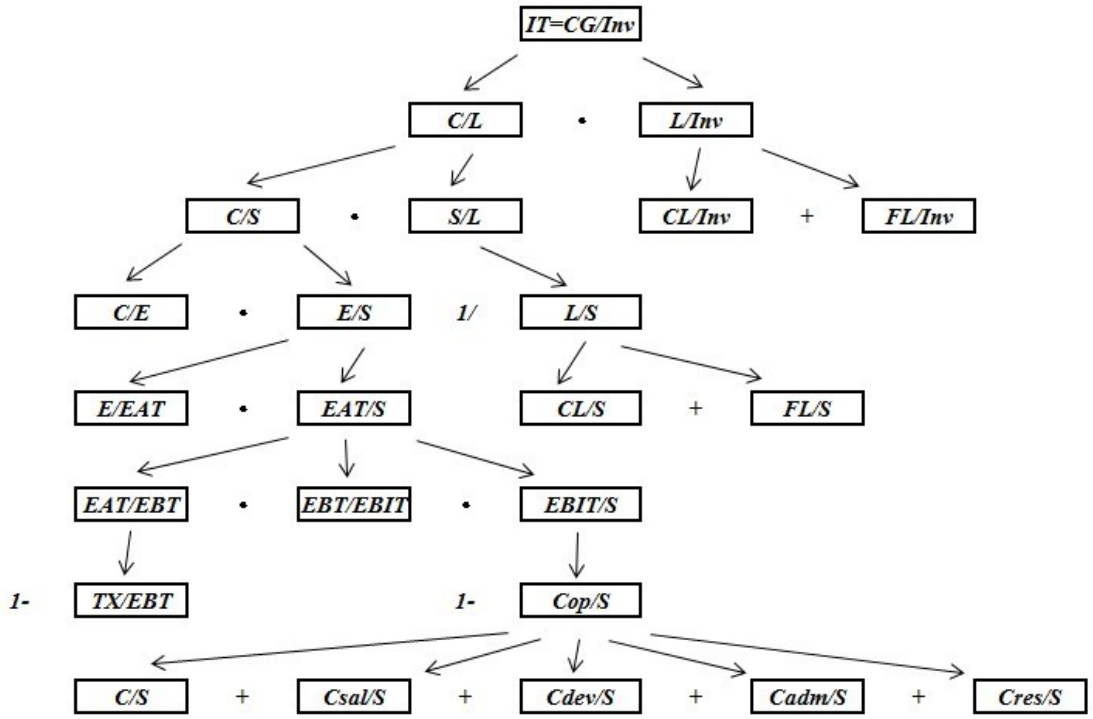
Chart 4.2 Adjustments of Decomposed Items of Current Assets Turnover Ratio



4.3.2 Inventory Turnover Ratio

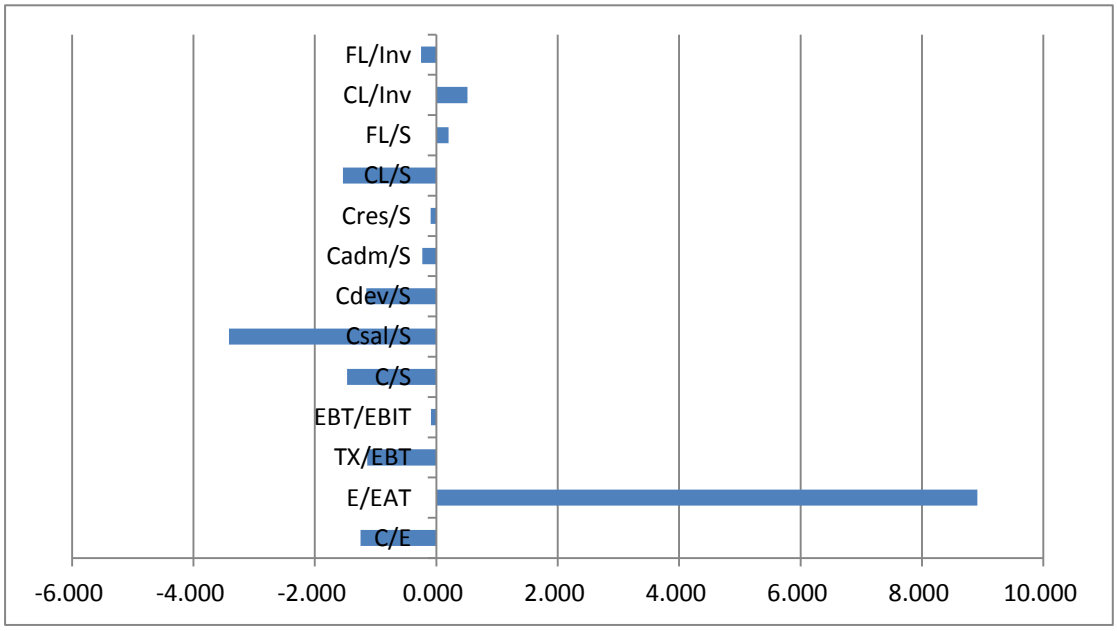
Indicator *IT* can be decomposed by various ways, for purpose of this thesis we created the decomposition which is depicted in image 4.1.

Image 4.1 Pyramidal Decomposition of Inventory Turnover Ratio



Where *CL* is "current liabilities" and *FL* refers "long-term liabilities". We also use data from 2011 to 2012 to analyze how to improve condition of GOME; the result of pyramidal decomposition is shown in chart 4.3, which are calculated through the gradual change method and additive operations.

Chart 4.3 Influences of Decomposed Indicators of *IT* from 2011 to 2012



The indicators that influence badly on *IT* most are C_{sal}/S, *C/S* and *CL/S*. We can try

to change some items in negative indicators to analyze what items can help GOME improve its *IT*.

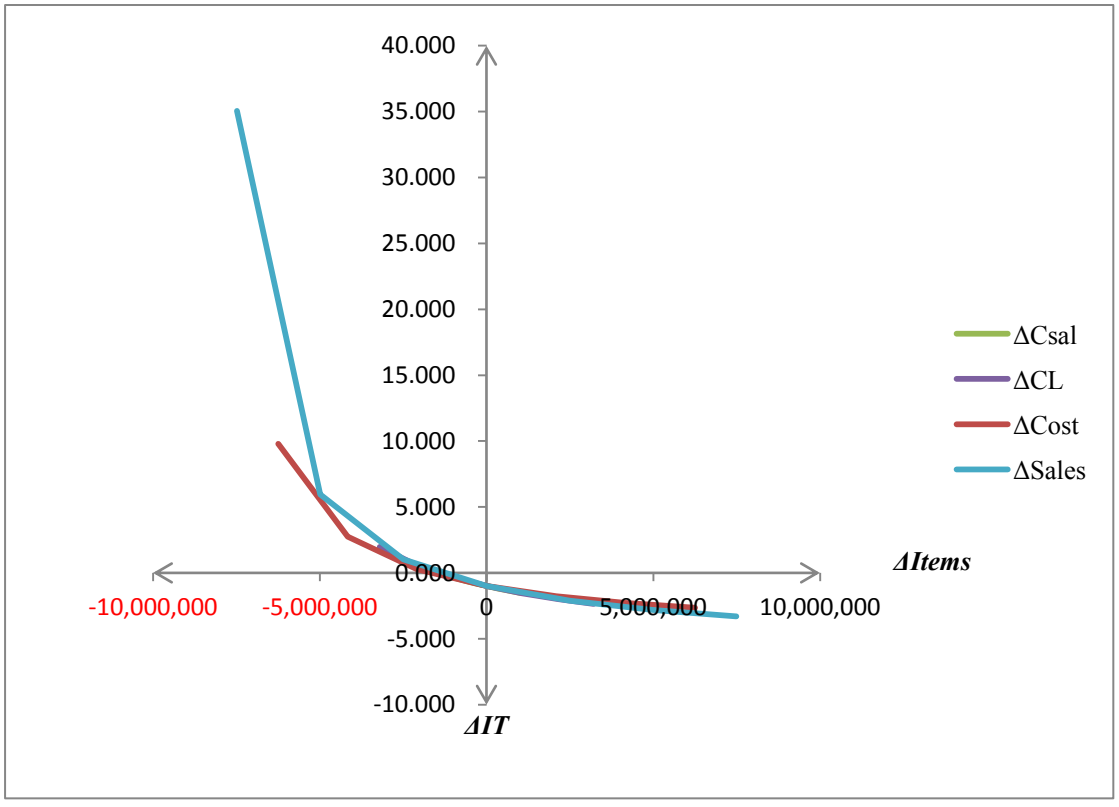
Table 4.17 Adjustment of Decomposed Indicators of *IT*

Changes(%)	△Cost	*△IT*	△Csal	*△IT*	△CL	*△IT*	△Sales	*△IT*
15%	6,249,670	-2.655	1,020,587	-1.528	3,205,524	-2.344	7,487,683	-3.297
10%	4,166,447	-2.285	680,392	-1.366	2,137,016	-1.987	4,991,788	-2.815
5%	2,083,223	-1.771	340,196	-1.192	1,068,508	-1.550	2,495,894	-2.115
0%	0	-1.004	0	-1.004	0	-1.004	0	-1.004
-5%	(2,083,223)	0.261	(340,196)	-0.799	(1,068,508)	-0.300	(2,495,894)	1.031
-10%	(4,166,447)	2.740	(680,392)	-0.578	(2,137,016)	0.640	(4,991,788)	5.956
-15%	(6,249,670)	9.799	(1,020,587)	-0.336	(3,205,524)	1.959	(7,487,683)	35.045

(Unit for ΔItem is RMB'000)

From table 4.17 we can find out that the decreasing of cost of goods sold, sales cost, current liabilities and sales can help GOME improve its inventory turnover ratio. In order to find out which item influence the *△IT* most efficient, we can turn table 4.17 into chart 4.4.

Chart 4.4 Adjustments of Decomposed Items of Inventory Turnover Ratio



We can see from chart 4.4 that the tendency of $\triangle CL$ and $\triangle C_{sal}$ are coincided to part of the tendency of $\triangle Cost$ and $\triangle Sales$. This means the efficiency to improve inventory turnover ratio by decreasing these items are almost the same. But we can find the different between the tendency of $\triangle Cost$ and $\triangle Sales$ when the percentage changes are -10% and -15%.

If we decrease the amount of sales by 15%, the $\triangle IT$ will be approximately 35 and the tendency of $\triangle Sales$ changes sharply. When we decrease sales, the net profit will be decreased and so will the amount of equity, according to formula 2.1, the amount of assets will also decrease. In order to reach the goal of improving inventory turnover ratio, we can decrease the amount of inventories. And because the different base amount of sales and inventories, when we decrease sales by 15%, the decreased amount will reach 7 billion RMB, which almost is the total amount of inventories. This makes the denominator of *IT* become tiny according to formula 2.18 and the result of $\triangle IT$ can be enormous compared with the results of other percentage changes. The sharply change of the tendency of $\triangle Cost$ when we decrease the cost of goods sold by 15% can be explained in the similar way.

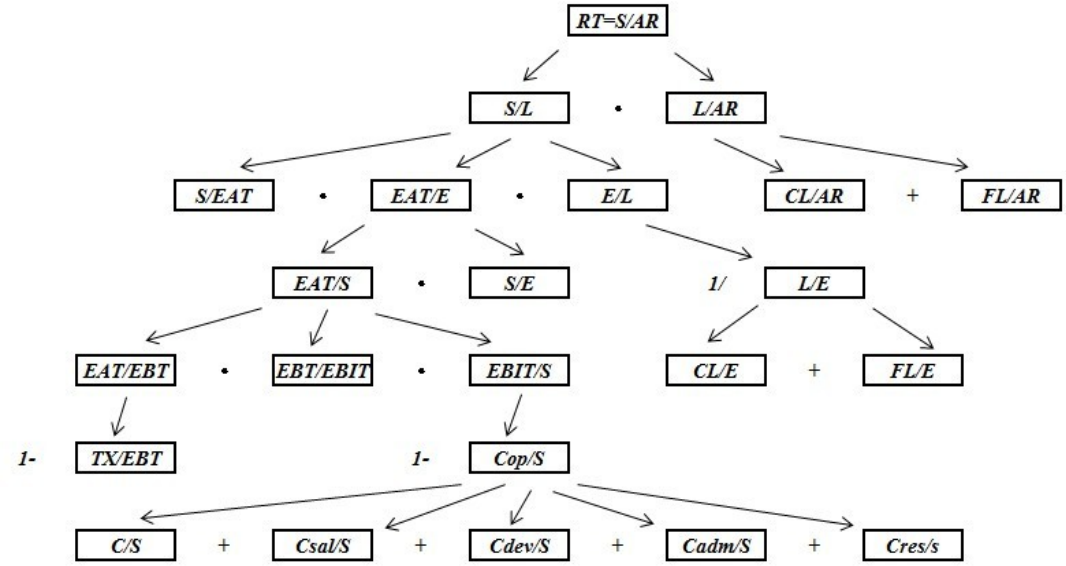
Although the high inventory turnover ratio is good for company, but if the *IT* is too high, it shows the company exist some problems like inventory level is too low for company. And the decreasing of sales is not good for the profitability of company, if we decrease sales by 15%, GOME will make loss.

If we can decrease the cost of goods sold by 10% or 15%, the inventory turnover ratio will be improved appropriately, and the decrease of cost of goods sold can also help GOME increase its profitability ratios.

4.3.3 Receivable Turnover Ratio

Another important indicator of activity ratio is *RT*. Indicator *RT* can be decomposed by various ways, for purpose of this thesis we created the decomposition which is depicted in image 4.2.

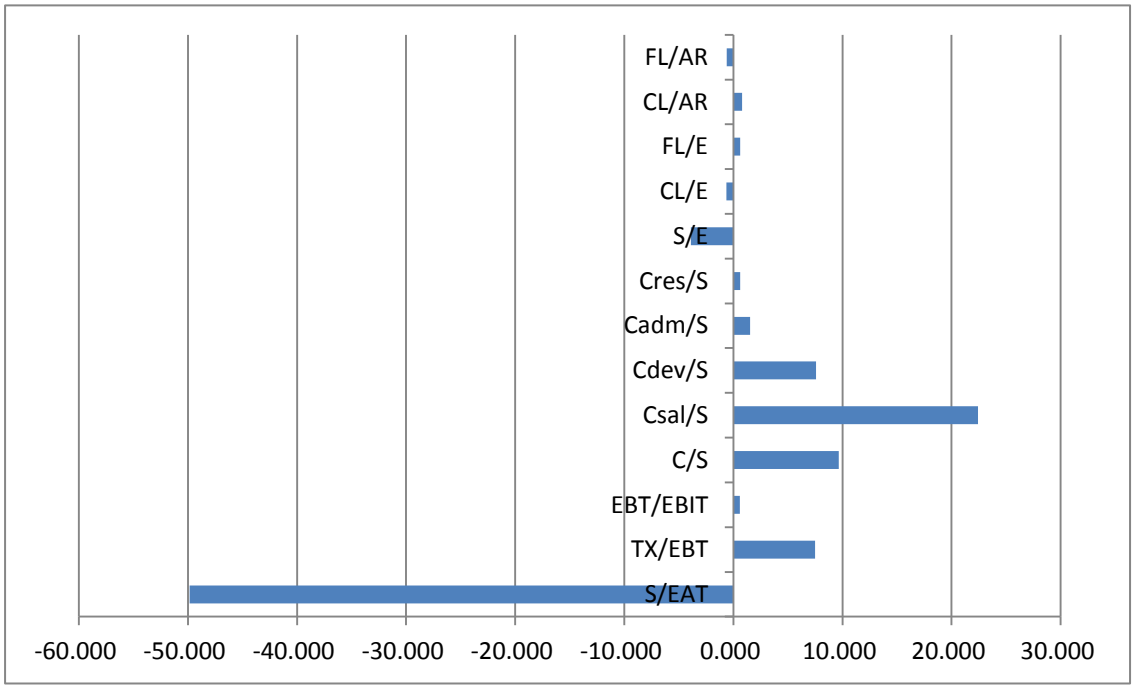
Image 4.2 Pyramidal Decomposition of Receivable Turnover Ratio



Through the decomposition from image 4.2 by using data from 2011 to 2012, we can finally work out the influence that each indicator made on *RT* by using the gradual change method to calculate and additive operations.

From chart 4.5 we can see *S/EAT* and *S/E* influence *RT* most. In order to make adjustment to these indicators, we can change the amount of sales and equity. We will change these items to see if we can improve *RT*.

Chart 4.5 Influences of Decomposed Indicators of *RT* from 2011 to 2012



We can know from table 4.18 that the decreasing of equity and current liabilities and the increasing of sales are good for GOME's receivable turnover ratio. But this activity ratio should not be as high as possible, if *RT* is too high, it will also be bad for company. If the $\triangle RT$ is 24.583 from 2011 to 2012 when we decrease equity by 15%, the *RT* in 2012 for GOME will be 38.953. This *RT* is too high for GOME; it will limit the increasing of sales.

Table 4.18 Adjustment of Decomposed Indicators of *RT*

Changes(%)	**△Sales**	**$\triangle RT$**	**△Equity**	**$\triangle RT$**	**△CL**	**$\triangle RT$**
15%	7,487,683	-1.595	2,300,446	-9.492	3,205,524	-10.665
10%	4,991,788	-2.315	1,533,630	-8.166	2,137,016	-9.240
5%	2,495,894	-3.034	766,815	-6.359	1,068,508	-7.143
0%	0	-3.754	0	-3.754	0	-3.754
-5%	(2,495,894)	-4.473	(766,815)	0.330	(1,068,508)	2.653
-10%	(4,991,788)	-5.193	(1,533,630)	7.651	(2,137,016)	19.339
-15%	(7,487,683)	-5.912	(2,300,446)	24.583	(3,205,524)	171.501

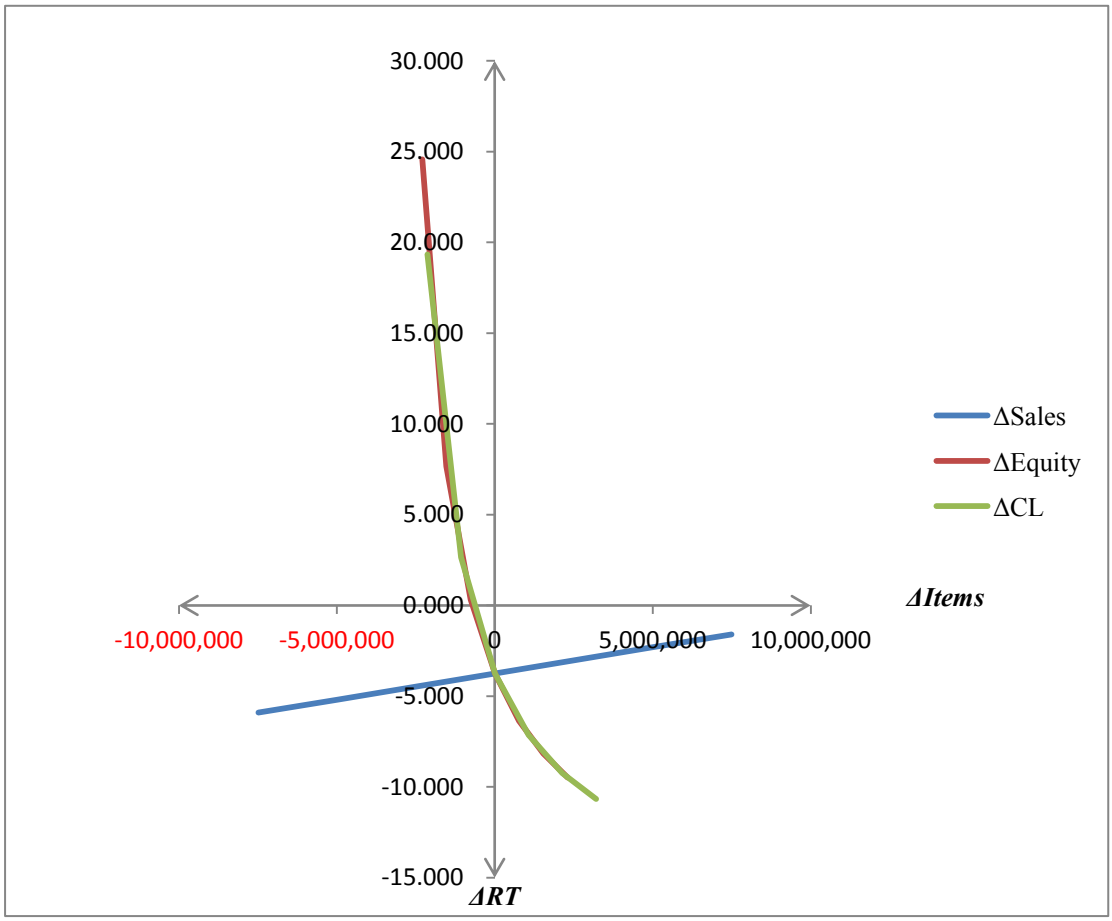
(Unit for ΔItems is RMB'000)

The curve of $\triangle Equity$ is not linear, this is because the change of equity can influence account receivable turnover ratio indirectly. As we explained before, the reason is the different base amount between equity and account receivables. If we decrease the amount of equity by15%, the assets should be decreased by the same amount. In order to reach the goal of improving *RT*, we should decrease the amount of account receivables. This make the denominator of *RT* become tiny, and the result of $\triangle RT$ will become enormous. And this changed amount is not 15% of account receivables, thus, the denominator of *RT* according to formula 2.16 is not changed by equal percentage, which explain the reason that $\triangle Equity$ has a nonlinear curve. The reason that $\triangle CL$ has a nonlinear curve can be explained in the similar way.

From chart 4.6 we can find out that the tendency of $\triangle Sales$ is more gentle than the tendency of $\triangle Equity$ and $\triangle CL$. Decreasing one unit of equity and current liabilities has higher efficiency on improving receivable turnover ratio than increasing one unit of sales. As we discussed before, *RT* is not good for company as high as possible, company should keep receivable turnover ratio in a normal level among the industry.

If GOME improves its *RT* by decreasing equity or current liabilities, it should keep the percentage changes in a narrow rage.

Chart 4.6 Adjustments of Decomposed Items of Account Receivable Turnover Ratio

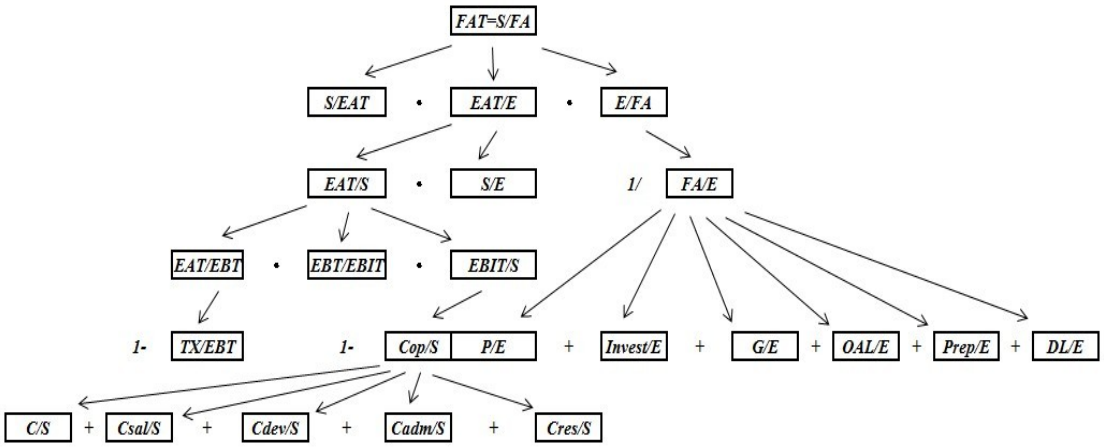


We suggest managers to decrease the current liabilities of GOME by 5% or decrease equity by 10%; *RT* can be improved appropriately through this way. Manager can also try to increase the amount of sales; it can help improve both profitability and *RT*.

4.3.4 Fixed Assets Turnover Ratio

Indicator *FAT* can be decomposed by various ways, for purpose of this thesis we created the decomposition which is depicted in image 4.3. We can calculate the increment of each indicator decomposed from *FAT* by using the gradual change method and additive operations.

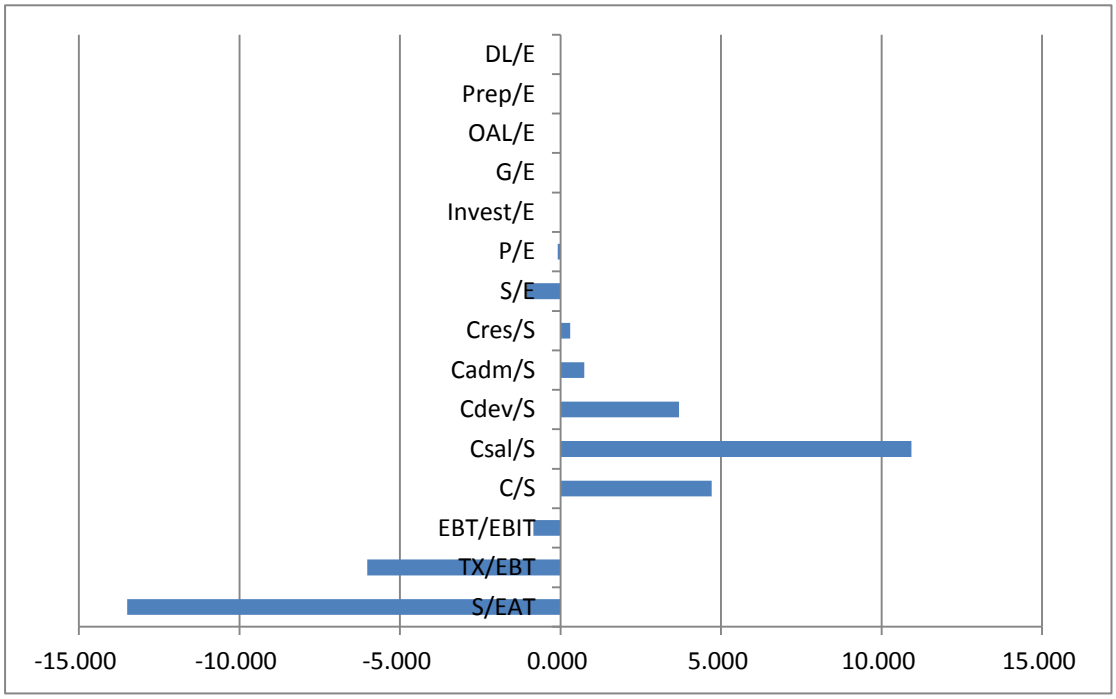
Image 4.3 Pyramidal Decomposition of Fixed Assets Turnover Ratio



Where *P* is "plant and equipment", *Invest* is "investment", *G* is "goodwill", *OAL* is "other long-term assets", *Prep* is "prepayments" and *DL* is "designated loan". Through the decomposition from image 4.3 by using data from 2011 to 2012, we can get the influence that each indicator made on *FAT*.

From chart 4.7 we can know *S/EAT*; *TX/EBT* and *S/E* are the indicators that have the most bad influence on *FAT*. As we discussed before, the amount of taxes cannot be controlled by company, so we can adjust the indicator *TX/EBT* by changing the amount of sales.

Chart 4.7 Influences of Decomposed Indicators of *FAT* from 2011 to 2012



We will make some adjustments to items in these indicators to find out what should managers do to improve *FAT*.

Table 4.19 Adjustment of Decomposed Indicators of *FAT*

Changes(%)	△Sales	⊿*FAT*	△Equity	⊿*FAT*	⊿*P*	⊿*FAT*
15%	7,487,683	-0.587	2,300,446	-1.707	602,845	-1.315
10%	4,991,788	-0.775	1,533,630	-1.541	401,897	-1.262
5%	2,495,894	-0.963	766,815	-1.357	200,948	-1.207
0%	0	-1.151	0	-1.151	0	-1.151
-5%	(2,495,894)	-1.339	(766,815)	-0.921	(200,948)	-1.094
-10%	(4,991,788)	-1.527	(1,533,630)	-0.660	(401,897)	-1.034
-15%	(7,487,683)	-1.715	(2,300,446)	-0.363	(602,845)	-0.972

(Unit for ΔItem is RMB'000)

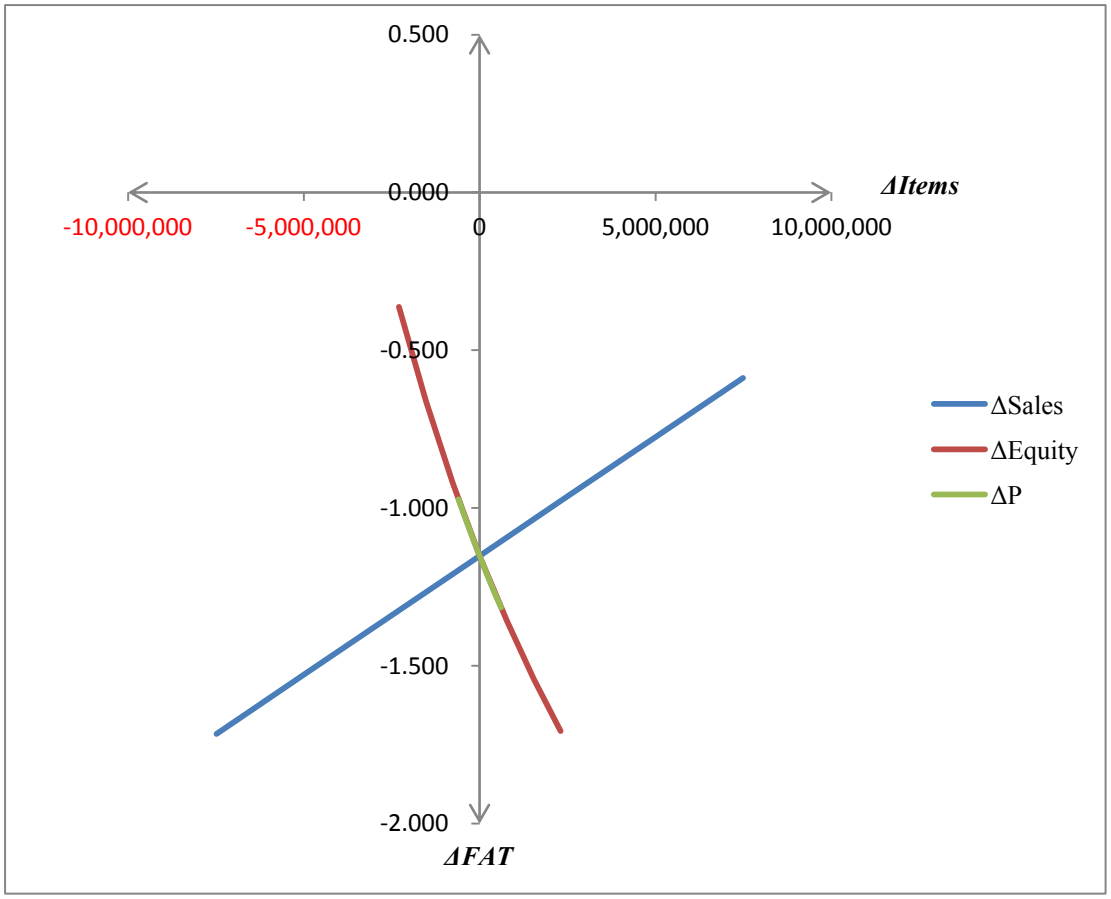
Seen from table 4.19, the increase of sales and the decrease of equity can both improve fixed assets turnover ratio, and the decrease of fixed assets like plant and equipment can also improve fixed assets turnover ratio. We can turn the data in table 4.19 into chart 4.8, which is more readable for us to find out what adjustments we should make to improve *FAT*.

From chart 4.8 we can find out the slope of ⊿*Equity* and ⊿*P* are bigger than the slope of ⊿*Sales*, this means the efficiency of decreasing one unit equity or fixed assets to improve *FAT* is higher than the efficiency of increasing one unit sales to improve *FAT*. We can find out that the tendency of ⊿*P* is coincided to the tendency of ⊿*Equity* in chart 4.8. This is because when we decrease the amount of equity, the amount of assets should be decreased by the same amount. So the improvements on fixed assets turnover ratio by adjusting the equity will has the same effect with adjusting the fixed assets.

The curve of ⊿*Equity* and ⊿*P* are totally coincided, which means the change of these items has the same effect on *FAT*. This is because when we change the amount of equity, we will make the same change with assets, and we should make this change with the items in fixed assets to reach the goal of improving fixed assets turnover ratio. And the curve of ⊿*Equity* and ⊿*P* are not linear, this is because that the base amount between *P* and fixed assets is different; although the item "plant and

equipment" is a part of fixed assets, but the amount of 5% of this item is not equal to the amount of 5% of fixed assets, which shows the denominator of *FAT* according to formula 2.22 is not changed by equal percentage.

Chart 4.8 Adjustments of Decomposed Items of Fixed Assets Turnover Ratio



From the analysis above, we suggest managers decrease the amount of equity or fixed assets to improve the fixed assets turnover ratio. Because the amount of $\triangle FAT$ is still negative when we make 15% changes to equity and fixed assets, we suggest managers decrease the amount of fixed assets and try to increase the amount of sales at the same time; this will help $\triangle FAT$ improves more effectively.

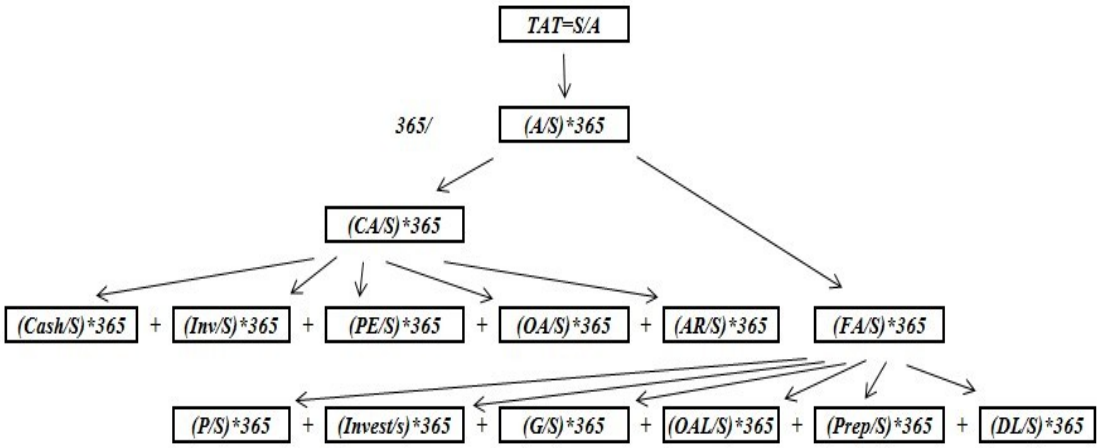
4.3.5 Total Assets Turnover Ratio

Total assets turnover ratios is a comprehensive activity ratio, it has similarity with current assets turnover ratio and fixed assets turnover ratio.

Indicator *TAT* can be decomposed by various ways, for purpose of this thesis we

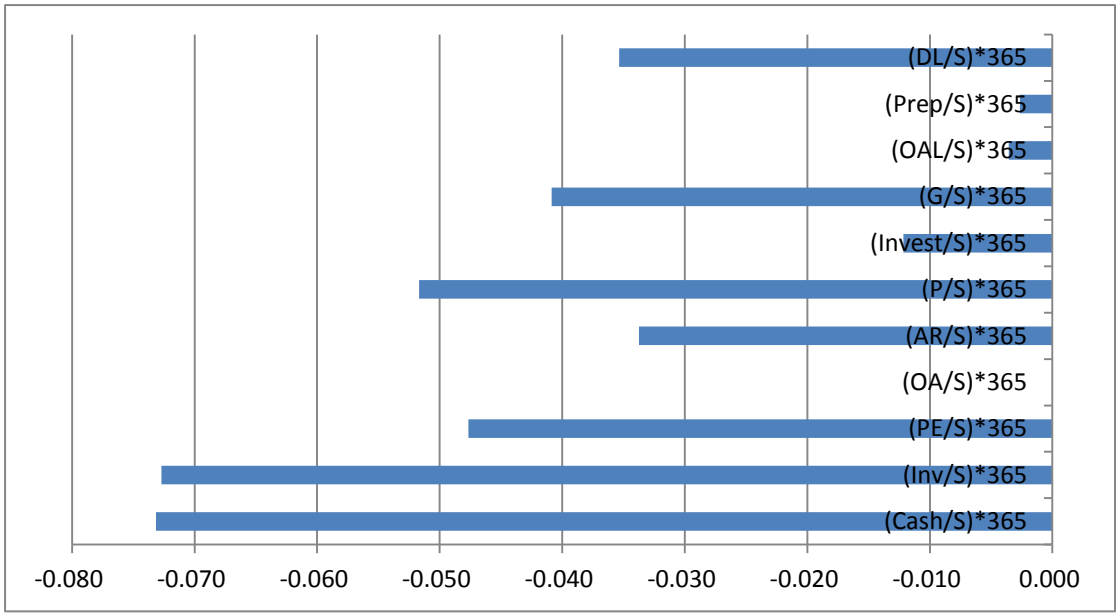
created the decomposition which is depicted in image 4.4. We can calculate the increment of each indicator decomposed from *FAT* by using the logarithmic method and additive operations.

Image 4.4 Pyramidal Decomposition of Total Assets Turnover Ratio



Where *Cash* is cash and cash equivalent, *Inv* is inventory, *PE* is prepaid expenses, *OA* is other assets and *AR* is account receivable. Through the decomposition from image 4.4 by using data from 2007 to 2012, we can get the influence that each indicator made on *TAT*.

Chart 4.9 Influences of Decomposed Indicators of *FAT* from 2011 to 2012



Seen from chart 4.9, almost every item has some tiny negative influence on *TAT*; but what influence the most are *Cash/S*, *Inv/S* and *P/S*, we can change some items in

these indicators to see how to improve *TAT*.

We can classify the items into 3 types: current assets like cash and inventory; non-current assets like plant and equipment; sales. For total assets turnover ratio, the adjustment to these 3 types of items will get the similar results shown in table 4.20.

Table 4.20 Adjustment of Decomposed Indicators of *TAT*

Changes(%)	**△Cash**	***△TAT***	**△P**	***△TAT***	**△Sales**	***△TAT***
15%	952,684	-0.408	602,845	-0.395	7,487,683	-0.603
10%	635,123	-0.396	401,897	-0.388	4,991,788	-0.535
5%	317,561	-0.385	200,948	-0.381	2,495,894	-0.460
0%	0	-0.373	0	-0.373	0	-0.373
-5%	(317,561)	-0.362	(200,948)	-0.366	(2,495,894)	-0.275
-10%	(635,123)	-0.350	(401,897)	-0.358	(4,991,788)	-0.161
-15%	(952,684)	-0.337	(602,845)	-0.351	(7,487,683)	-0.027

(Unit for ΔItem is RMB'000)

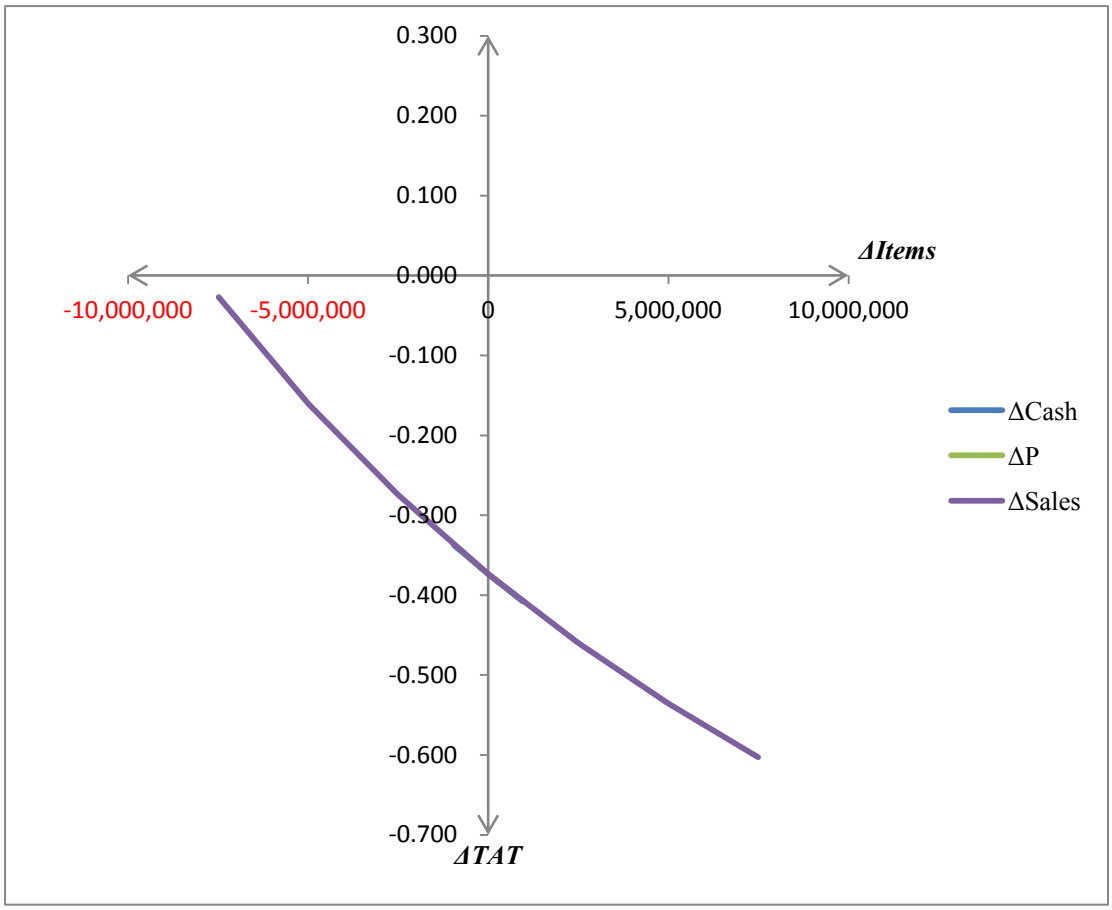
All the decrease of items can help improve the total assets turnover ratio, in order to find out whether there exist differences between the tendencies of the improvements to *FAT*, we can turn table 4.20 into chart 4.10.

Seen from chart 4.10, we can find out that the curve of $\triangle Cash$ and $\triangle P$ can be coincided to the curve of $\triangle Sales$. This is because current assets and non-current assets are belong to total assets, the adjustment to any item in these assets will change the amount of total assets, and the influences that they made on total assets turnover ratio are the same. If we improve *TAT* by decreasing the amount of sales, equity will be decreased at the same time and so will the assets. For *TAT*, the decrease of sales has the same effect with the decrease of assets.

The curve of these items is not linear, as we explained before, because the different case amount, the equal percentage that made on these decomposed items does not mean the equal percentage change in numerator or denominator in formula 2.24, which make the curve nonlinear.

We suggest managers decrease assets instead of decreasing sales, because the decreasing of sales will decrease the profitability ratios, which is bad for profitability of the company.

Chart 4.10 Adjustments of Decomposed Items of Total Assets Turnover Ratio



4.4 Summary of Activity Analysis

Chapter 4 is the most important part of the thesis, it analyzed the problem exist in GOME and give some suggestions about how to solve the problems.

Through the financial ratio analysis we found out that the activity ratios are in normal level, but they are decreasing slowly; the profitability ratios in 2012 are too low to generate profit, GOME need to increase sales or decrease costs to improve profitability ratios; the liquidity ratios and solvency ratios are both keep in normal levels, but compare with its competitor, these ratios still need to be improved. In the pyramidal decomposition part we made activity evaluation, we have given some suggestions to help managers improve its activity ratios.

For inventory turnover ratio, managers can decrease certain percentage of cost of goods sold; through the calculation, we suggest decrease by 10% or 15% will help GOME improve its inventory turnover ratio into good condition.

For receivable turnover ratio, managers can increase the amount of sales; this can improve both activity ratios and profitability ratios. We also suggest that managers can decrease the amount of current liabilities by 5% or 10% through the calculation.

For current assets turnover ratio, managers can decrease the equity to improve this ratio. Increasing sales to improve current assets turnover ratio has the similar effect compared with decreasing equity.

For fixed assets turnover ratio, we suggest managers increase the amount of sales and at the same time decrease the proportion of fixed assets to improve the level of fixed assets turnover ratio.

For total assets turnover ratio, managers can decrease the amount of assets to improve this ratio.

5. Conclusion

GOME always develop well as one of the biggest home appliance retailer in China, but recent years it doesn't performance well when it facing the bad condition. The first low point for GOME happened in 2008, the time that worldwide subprime mortgage crisis happened. The second low point for GOME happened in 2012, GOME had made loss in that year, both profitability and operating ability had been affected.

In order to reach the goal of the thesis, which is to analyze the financial situation in GOME and make activity evaluation, we studied the basic methods and the data sources of financial analysis in chapter 2. Through introducing the financial statements, common-size analysis, financial ratio analysis and pyramidal decomposition analysis, we learned the theoretical basis to help us solve the problem.

Then we introduced the basic history and information of GOME in chapter 3, and make common-size analysis of GOME's balance sheet and income statement. From the vertical common-size analysis, we knew the proportion of each item in financial statements; and from horizontal common-size analysis, we found out the most of the items changed widely from year to year. After all the common-size analysis we made towards GOME, we found the financial situation of GOME was not running well since 2011, there exist some external factors like economic crisis, but more important for this problem is the internal causes.

According to the analysis in chapter 4, we found the financial situation of GOME is not good by calculating financial ratios. Since 2011, the profitability ratios of GOME have decreased sharply. Solvency ratios and liquidity ratios also need improvements compared with its competitor. Then we made activity evaluation of GOME through pyramidal decomposition. We also give suggestions to managers about how to improve each activity ratio.

From pyramidal decomposition we can find out that GOME should decrease cost of goods sold to improve inventory turnover ratio; decrease the amount of equity to improve current assets turnover ratio and receivable turnover ratio; decrease the

amount of fixed assets to improve fixed assets turnover ratio and total assets turnover ratio.

Compared with its main competitor SUNING, GOME still need to improve a lot. Seen from financial ratios of SUNING, we can find SUNING always do some adjustment to its financial ratios to help the ratios stay in normal level. GOME should also lay emphasis on this problem, keep noticing its financial ratio to realize its financial situation, and try to make some improvements.

After solving these basic problems, we think the financial situation of GOME should be improved and GOME can achieve its goal and enlarge company in the future, and at that time, GOME will become more competitive.

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List of Abbreviation

ROE: Return on Equity

ROA: Return on Assets

EAT: Earnings after Tax

CR: Current Ratio

CA: Current Assets

CL: Current Liabilities

FL: Non-current Liabilities

QR: Quick Ratio

MS: Short-term Marketable Securities

AR: Account Receivables

D/A: Debt-to-assets Ratio

D/E: Debt-to-equity Ratio

E: Shareholder's Equity

TA: Total Assets

TD: Total Debt

EPS: Earnings per Share

NS: Number of shares outstanding

P/E: Price-to-earnings Ratio

MPS: Marketing Price per Share

RT: Account Receivables Turnover Ratio

TR: Total Revenue

AAR: Average Accounts Receivables

RD: Account Receivables Turnover in Days

IT: Inventory Turnover Ratio

ID: Inventory Turnover in days

CG or C: Cost of Goods Sold

AI: Average Inventory

CAT: Current Assets Turnover Ratio

CAD: Current Assets Turnover in Days

ACA: Average Current Assets

FAT: Fixed Assets Turnover Ratio

FAD: Fixed Assets Turnover in Days

NVFA: Net Value of Fixed Assets

TAT: Total Assets Turnover Ratio

TAD: Total Assets Turnover in Days

ATA: Average Total Assets

C_{op}: Total Cost

C_{sal}: Sales Cost

C_{adm}: Administrative Cost

C_{dev}: Development Cost

C_{res}: Rest of Cost

Cash: Cash and cash equivalent

Inv: Inventory

OA: Other Assets

PE: Prepaid Expenses

P: Plant and Equipment

Invest: Investment

G: Goodwill

OAL: Long-term Other Assets

Prep: Prepayments

DL: Designated Loan

Declaration of Utilization of Results from a Diploma (Bachelor) Thesis

Herewith I declare that

- I am informed that Act No. 121/2000 Coll. – the Copyright Act, in particular, Section 35 – Utilization of the Work as a Part of Civil and Religious Ceremonies, as a Part of School Performances and the Utilization of a School Work – and Section 60 – School Work, fully applies to my diploma (bachelor) thesis;
- I take account of the VSB – Technical University of Ostrava (hereinafter as VSB-TUO) having the right to utilize the diploma (bachelor) thesis (under Section 35(3)) unprofitably and for own use ;
- I agree that the diploma (bachelor) thesis shall be archived in the electronic form in VSB-TUO's Central Library and one copy shall be kept by the supervisor of the diploma (bachelor) thesis. I agree that the bibliographic information about the diploma (bachelor) thesis shall be published in VSB-TUO's information system;
- It was agreed that, in case of VSB-TUO's interest, I shall enter into a license agreement with VSB-TUO, granting the authorization to utilize the work in the scope of Section 12(4) of the Copyright Act;
- It was agreed that I may utilize my work, the diploma (bachelor) thesis, or provide a license to utilize it only with the consent of VSB-TUO, which is entitled, in such a case, to claim an adequate contribution from me to cover the cost expended by VSB-TUO for producing the work (up to its real amount).

Ostrava dated....1.5.2014.....

.....MINYI DONG 董敏怡.....

Student´s name and surname

List of Annexes

Annexes

Annex 1: Consolidated Balance Sheet

	2007 RMB'000	2008 RMB'000	2009 RMB'000	2010 RMB'000	2011 RMB'000	2012 RMB'000
Assets						
Non-current Assets						
property, plant and equipment	3,144,458	3,719,829	3,391,950	3,556,163	3,874,370	4,163,569
investment properties	331,680	389,473	820,671	830,611	915,226	918,472
goodwill	3,343,012	3,363,012	4,014,981	4,014,981	4,030,771	4,030,771
other intangible assets	143,867	134,241	125,199	116,157	108,660	99,438
other investments		108,810	153,360	127,710	145,800	124,200
prepayments for acquisition of properties	138,300	270,160	21,129			
lease prepayments	342,744	355,089	332,407	387,784	401,994	330,953
deferred tax assets	55,873	18,356	30,763	39,513	66,663	136,852
designated loan			3,600,000	3,648,000	3,600,000	3,600,000
other assets		653,423				
total non-current assets	7,499,934	9,012,393	12,490,460	12,720,919	13,143,484	13,404,255
Current assets						
Hong Kong listed investments, at fair value	1,058	399	1,635			
investment deposits	30,000	30,000				
designated loan	1,500,000	3,600,000				
inventories	5,383,039	5,473,497	6,532,453	8,084,971	9,625,044	7,385,352
trade and bills receivables	97,719	45,092	54,199	206,102	199,598	194,746
prepayments, deposits and other receivables	2,211,998	1,384,355	1,701,884	2,446,051	3,729,456	2,542,750
due from related parties	79,024	57,843	157,146	251,290	169,390	101,539
derivative component of convertible bonds				7,349		
other financial assets	150,000					
pledged deposits	6,614,725	4,840,456	8,796,344	6,268,130	4,388,998	6,019,027
cash and cash equivalents	6,269,996	3,051,069	6,029,059	6,232,450	5,971,498	6,730,960
total current assets	22,337,559	18,482,711	23,272,720	23,496,343	24,083,984	22,974,374
Total Assets	29,837,493	27,495,104	35,763,180	36,217,262	37,227,468	36,378,629

Equity And Liabilities						
Equity attributable to equity holders of the parent						
issued capital	343,764	331,791	382,408	417,666	421,521	421,551
reserves	9,630,586	8,228,043	11,420,057	13,735,246	15,527,242	14,727,528
proposed final dividend	328,629			582,275		
total	10,302,979	8,559,834	11,802,465	14,735,187	15,948,763	15,149,079
Minority interests	89,689	140,201			-30,469	-394766
Total Equity	10,392,668	8,700,035	11,802,465	14,735,187	15,918,294	14,754,313
Non-current liabilities						
deferred tax liabilities	80,431	78,269	103,429	111,148	92,961	95,263
convertible bonds	3,184,303	3,569,553	3,174,909	1,814,069		4,953
total non-current liabilities	3,264,734	3,647,822	3,278,338	1,925,217	92,961	100,216
Current liabilities						
interest-bearing bank loans	300,000	170,000	350,000	100,000		2,434,374
trade and bills payables	13,556,545	12,917,958	15,815,261	16,899,683	17,140,383	16,971,671
customers' deposits, other payables and accruals	1,939,695	1,530,141	1,829,514	1,819,999	1,523,315	1,631,309
due to a related party				97,826		112,480
convertible bonds			2,180,357	129,976	2,111,610	
tax payable	383,851	529,148	507,245	509,374	440,905	374,266
total current liabilities	16,180,091	15,147,247	20,682,377	19,556,858	21,216,213	21,524,100
Total Liabilities	19,444,825	18,795,069	23,960,715	21,482,075	21,309,174	21,624,316
Total Equity And Liabilities	29,837,493	27,495,104	35,763,180	36,217,262	37,227,468	36,378,629

Annex 2: Consolidated Income Statement

	2007 RMB'000	2008 RMB'000	2009 RMB'000	2010 RMB'000	2011 RMB'000	2012 RMB'000
Revenue	42,478,523	45,889,257	42,667,572	50,910,145	59,820,789	47,867,260
Cost of sales	-38,383,276	-41,381,223	-38,408,042	-44,991,355	-52,264,259	-41,664,469
Gross profit	4,095,247	4,508,034	4,259,530	5,918,790	7,556,530	6,202,791
Other income and gain	2,546,876	3,266,244	3,131,646	3,441,628	3,302,082	1,541,381
Selling and distribution costs	-3,547,907	-4,487,131	-4,352,350	-5,114,303	-6,903,543	-6,803,916
Administrative expenses	-686,740	-828,028	-845,235	-1,165,138	-1,218,501	-1,423,057
Other expenses	-604,768	-515,357	-490,062	-375,323	-413,238	-418,717
Profit from operating activities	1,802,708	1,943,762	1,703,529	2,705,654	2,323,330	-901,518
Finance costs	-193,369	-212,118	-348,969	-441,818	-241,772	-227,708
Finance income	424,241	441,017	341,209	339,036	400,291	441,221
Loss/gain in the derivative components of convertible bonds	-505,483	-189,220	136,740	-93,340	-7,349	
Impairment of other investments		-449,592				34,011
Profit before tax	1,528,097	1,533,849	1,832,509	2,509,532	2,474,500	-653,994
Tax	-360,262	-435,156	-406,310	-547,878	-673,154	-155,997
Profit for the year	1,167,835	1,098,693	1,426,199	1,961,654	1,801,346	-809,991
Attributable to:						
Equity holders of the parent	1,127,307	1,048,160	1,409,288	1,961,654	1,839,867	-596,614
Minority	40,528	50,533	16,911		-38,521	-213,377

interests						
Profit for the year	1,167,835	1,098,693	1,426,199	1,961,654	1,801,346	-809,991

Annex 3: Consolidated Cash Flow Statement

	2007 RMB'000	2008 RMB'000	2009 RMB'000	2010 RMB'000	2011 RMB'000	2012 RMB'000
Cash Flows From Operating Activities						
Profit before tax	1,528,097	1,533,849	1,832,509	2,509,532	2,474,500	-653,994
Adjustments for:						
Finance income	-424,241	-441,017	-341,209	-339,036	-400,291	-441,221
Finance cost	193,369	212,118	348,969	441,818	241,772	227,708
Loss/(gain) on the derivative components of convertible bonds	505,483	189,220	-136,740	93,340	7,349	
Gain on repurchases of the Old 2014 Convertible Bonds			-67,083			
Gain on redemption of the Old 2014 Convertible Bonds				-202,578		-15,998
Gain on redemption of the New 2014 Convertible Bonds						-18,013
Impairment of goodwill		8,000	2,000			
impairment of other investments		449,592				
Impairment of property, plant and equipment		31,725				
Fair value loss on a cross currency swap						4,953
Fair value loss on transfer of owner-occupied rpoperties to investment properties					9,756	
Fair value loss on property, plant and equipment		6,632	81,493			
Fair value gain/(loss) on investment properties	-47,176	34,441	3,723	8,488	-25,650	-29,739
Fair value gain/(loss) on Hong Kong listed investments	-150	659	-1,236	29		
Depreciation	256,988	296,256	345,597	332,543	397,217	451,438
Loss on disposal of items of property, plant and	13,104	13,763	28,798	16,287	498	6,796

equipment						
Gain on diaposal of a jointly-controlled entity		-3				
Amortisation of intangible assets	8,457	9,626	9,042	9,042	9,222	9,222
Cash settlement for top-up subscription shares for warrants			18,608			
Equity-settled share option expenses			70,533	93,803	54,071	800
Transaction cost related to the derivative components of convertible bonds						
Increase in lease prepayments	-279,970	-12,345	22,682	-55,377	-15,387	71,041
Increase in inventories	-466,578	-90,458	-1,058,956	-1,552,518	-1,522,736	2,239,692
Increase in trade and bills receivables	-10,230	52,627	-9,107	-151,903	6,504	4,852
(Increase)/decrease in prepayments, deposits and other receivables	-839,136	1,007,795	-378,627	-736,966	-1,280,142	1,014,540
Decrease/(increase) in amounts due from related parties	110,439	21,181	-99,303	-94,144	78,900	67,851
Increase in amounts due to related parties				97,826	-97,826	112,480
Decrease in other financial assets		150,000				
Decrease/(increase) in pledged deposits	839,449	1,774,269	-3,955,888	2,528,214	1,879,132	837,978
Increase in trade and bills payable	887,997	-638,587	2,897,303	1,084,422	227,200	-168,712
Increase/(decrease) in customers' deposits, other payables and accruals	547,003	-335,928	144,475	-9,515	-315,691	97,228
(Decrease)/increase in amounts due to a related party	-120,564					
Cash generated from operations	2,702,341	4,273,415	-242,417	4,073,307	1,728,398	3,818,902

Interest received	390,864	260,645	507,734	352,953	406,776	608,887
Dividends paid	-364,311	-661,090			-964,758	
PRC income tax paid	-168,171	-262,610	-440,023	-553,081	-787,145	-290,523
Net Cash Inflow/(Outflow) From Operating Activities	2,560,723	3,610,360	-174,706	3,873,179	383,271	4,137,266
Cash Flow From Investing Activities						
Purchases of items od property, plant and equipment	-1,578,294	-1,179,635	-329,527	-507,287	-861,450	-783,289
Proceeds from disposal of items of property, plant and equipment	1,245	15,042	6,555	746	83,422	62,235
Proceeds from disposal of Hong Kong listed investments				1,606		
Acquisition of subsidiaries	-6,558	-8,000			41,835	
Acquisition of minority interests	-13,158					
Payment of outstanding considerations for business combination		-45,000	-2,760			
Transaction costs of the acquisition		-543,552				
Disposal of a jointly-controlled entity	-5,526					
Prepayment for acquisition of a subsidiary	-10,000					
Designated loan	-1,500,000	-2,100,000		-48,000		
Increase in investment deposits	-30,000					
Increase in other assets		-653,423				
Cash receipt for investment deposits			31,891			
Net Cash Outflow From Investing Activities	-3,142,291	-4,514,568	-293,841	-552,935	-736,193	-721,054
Cash Flow From						

Financial Activities						
Proceeds from issue of shares	1,433,740		1,360,573			
Share issue expenses	-1,434		-75,674			
Repurchase of shares		-2,067,557			-14,574	
Repurchase of Old 2014 Convertible Bonds			-1,820,100			
Redemption of Old 2014 Convertible Bonds				-2,685,508		-155,181
Redemption of New 2014 Convertible Bonds						-2,442,861
Issue of convertible bonds	4,600,000		3,947,200			
Issue of warrants						
Transaction costs for issuing convertible bonds and warrents	-71,860		-89,994			
Exercise of share options				6,067	131,815	2,313
Exercise of warrants					164,425	
Cash settlement for top-up subscription shares for warrants			-18,608			
New bank loans	400,000	100,000	860,000	100,000		2,434,374
Increase in pledged deposits for bank loans						-2,468,007
Acquisition of non-controlling interests in subsidiaries						-3,900
Deemed disposal of non-controlling interests in subsidiaries						73,333
Repayment of bank loans	-829,330	-230,000	-680,000	-350,000	-100,000	
Interest paid	-40,789	-16,088	-16,064	-172,524	-74,207	-106,567
Net Cash Inflow From Financing Activities	5,490,327	-2,213,645	3,467,333	-3,101,965	107,459	-2,666,496
Net Increase In Cash And Cash Equivalents	4,908,759	-3,117,853	2,998,786	218,279	-245,463	749,716
Cash and cash equivalents at 1 January	1,451,837	6,269,996	3,051,069	6,029,059	6,232,450	5,971,498

Exchange differences	-90,600	-101,074	-20,796	-14,888	-15,489	9,746
Cash And Cash Equivalents At 31 December	6,269,996	3,051,069	6,029,059	6,232,450	5,971,498	6,730,960

Annex 4: Vertical Common-size Analysis of Balance Sheet

Vertical Analysis	2007	2008	2009	2010	2011	2012
Cash	21.01%	11.10%	16.86%	17.21%	16.04%	18.50%
Accounts Receivable	13.03%	18.50%	5.35%	8.02%	11.01%	7.80%
Inventory	18.04%	19.91%	18.27%	22.32%	25.85%	20.30%
Prepaid Expenses	22.27%	17.72%	24.60%	17.33%	11.79%	16.55%
Other Financial Assets	0.50%	0.00%	0.00%	0.00%	0.00%	0.00%
Other Assets	0.00%	2.38%	0.00%	0.00%	0.00%	0.00%
Non-current Assets	25.14%	30.40%	34.93%	35.12%	35.31%	36.85%
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Accounts Paybles	51.94%	52.55%	49.34%	51.69%	50.13%	51.14%
Accrued Expenses	1.01%	0.62%	7.08%	0.63%	5.67%	6.69%
Current Portion of Debt	0.00%	0.00%	0.00%	0.27%	0.00%	0.31%
Income Taxes Payable	1.29%	1.92%	1.42%	1.41%	1.18%	1.03%
deferred tax liabilities	0.27%	0.28%	0.29%	0.31%	0.25%	0.26%
convertible bonds	10.67%	12.98%	8.88%	5.01%	0.00%	0.01%
Shareholder's Equity	34.83%	31.64%	33.00%	40.69%	42.76%	40.56%
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Annex 5: Vertical Common-size Analysis of Income Statement

	2007	2008	2009	2010	2011	2012
Net Sales	100%	100%	100%	100%	100%	100%
Cost of Goods Sold	84.45%	83.44%	82.80%	82.26%	82.28%	83.47%
Gross Margin	15.55%	16.56%	17.20%	17.74%	17.72%	16.53%
Sales & Marketing	7.81%	9.05%	9.38%	9.35%	10.87%	13.63%
Research & Development	1.51%	1.67%	1.82%	2.13%	1.92%	2.85%
General & Administrative	1.33%	1.04%	1.06%	0.69%	0.65%	0.84%
Other Operating Costs	0.43%	0.43%	0.75%	0.81%	0.38%	0.46%
Operating Expenses	11.07%	12.18%	13.01%	12.98%	13.82%	17.78%
Income From Operations	4.47%	4.38%	4.19%	4.76%	3.91%	-1.24%
Interest Income	1.11%	1.29%	-0.29%	0.17%	0.01%	-0.07%
Profit before tax	3.36%	3.09%	3.90%	4.59%	3.90%	-1.31%
Income Taxes	0.79%	0.88%	0.88%	1.00%	1.06%	0.31%
Net Income	2.57%	2.22%	3.02%	3.59%	2.84%	1.62%

Operating Cost Part:

	2007	2008	2009	2010	2011	2012
Sales & Marketing	70.50%	74.26%	72.10%	72.07%	78.65%	76.68%
Research & Development	13.65%	13.70%	14.00%	16.42%	13.88%	16.04%
General & Administrative	12.02%	8.53%	8.12%	5.29%	4.71%	4.72%
Other Operating Costs	3.84%	3.51%	5.78%	6.23%	2.75%	2.57%
Operating Costs	100%	100%	100%	100%	100%	100%